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CIS

MINERAL ROYALTY COLLECTION, ACCOUNTING, AND DISTRIBUTION

HEARING

BEFORE THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

TO CONSIDER METHODS OF COLLECTING, ACCOUNTING, AND DISTRIBUTING MINERAL ROYALTIES AND RELATED ISSUES

CASPER, WYO., AUGUST 11, 1981

Publication No. 97-45

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CONTENTS

STATEMENTS

	Page
Frederick, Doyle G. Acting Director, U.S. Geological Survey, Department of the Interior, accompanied by William Feldmiller, Royalty Accounting, Denver office; Arnold E. Petty, Deputy Director for Services, Bureau of Land Management; and Jim Yohe, Assistant Inspector General, Department of the Interior	42, 48
Griffith, Jim, Wyoming State auditor	74, 77
Herschler, Hon. Ed., Governor, State of Wyoming as presented by Oscar Swan, State land commissioner for Wyoming	5
Melcher, Hon. John, a U.S. Senator from the State of Montana	3
Morton, Warren A., manager, M.K.M. Oil Co	95, 99
Petty, Arnold E., Deputy Director for Services, Bureau of Land Management	60
Simonette, John F., Associate Director, Accounting and Financial Management Division, General Accounting Office, accompanied by Jeffrey C. Steinhoff, Senior Group Director, Accounting and Financial Management Division; Darby Smith, senior accountant, Denver office; and Glen L. Baughman, supervisory auditor	24, 28
Simpson Hon. Alan K., a U.S. Senator from the State of Wyoming	4
Swenson, Jack G., executive vice president, Rocky Mountain Oil & Gas Association, Inc., accompanied by Wayne Smith, Amoco; Ron Beck, manager, Administrative Division, Amoco; and A. B. Slaybaugh, vice president and coordinating manager, western area, Conoco	108, 111
Wallop, Hon. Malcolm, a U.S. Senator from the State of Wyoming	1
Washakie, John, member of the Shoshone Business Council; accompanied by Pat Goggles, member of the Arapahoe Business Council; Leonard Moss, director of Joint Tribal Minerals Department; and Saul Goodman, Esq., attorney, Rogovin, Huge & Lenzner	82, 86

MINERAL ROYALTY COLLECTION, ACCOUNTING, AND DISTRIBUTION

TUESDAY, AUGUST 11, 1981

U.S. SENATE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
Casper, Wyo.

The committee met, pursuant to notice, at 1:57 p.m., at the Natrona County Public Library, Crawford Room, Casper, Wyo., Hon. Malcolm Wallop, presiding.

Present: Senators Wallop and Melcher.

Also present: Tony Bevinetto, professional staff member; and Benjamin S. Cooper, professional staff member for the minority.

OPENING STATEMENT OF HON. MALCOLM WALLOP, A U.S. SENATOR FROM THE STATE OF WYOMING

Senator WALLOP. Good afternoon and my thanks for all those who showed up to participate in the hearing and certainly all those who have come to watch. You are more than welcome.

This is an official hearing of the Committee on Energy and Natural Resources of the U.S. Senate. This is an oversight hearing in that no specific legislation is being considered, but rather hearing about how well things are working, or not working, under current law.

The Energy and Natural Resources Committee has jurisdiction as the title implies over all energy matters, legislation, and natural resource protection, extraction, regulation and distribution. The committee is responsible for legislation pertaining to, and authorization of all activities of the land managing agency. In short, consideration of the Mineral Leasing Act, as amended, is the responsibility of the Senate Energy and Natural Resources Committee. The activities of the Department of the Interior's land managing agencies, USGS, BLM, and others are the legislative responsibility of this committee.

This is a hearing of the full committee. The two subcommittees having responsibility in this areas are Public Lands and Reserved Water and Energy and Mineral Resources. The first is chaired by me, and the second by Senator Warner of Virginia.

As many of you know, the committees of Congress are the working bodies where investigation and oversight are studied. In the legislative flow, the subcommittee hearing process is the first step to see what is needed, what is going on, and what should be done. Since we have two subcommittees involved in this issue, the full committee hearing is called and here we are.

I would like to thank everyone again who has come here to participate. I would also like to say that I wish all the hearings that I have to go to were in Wyoming.

Wyoming is in fact the proper place to hold a hearing today as it is the State most affected by the problem we come here to discuss. That problem is money. Money that rightfully belongs to the oil-producer States such as Wyoming and to the Indian tribes. The Federal Government currently collects several billion dollars each year in royalties from leased Federal and Indian lands. They expect to collect in the neighborhood of $4 billion dollars this year, and the figure is projected to climb to $20 billion by 1990. Wyoming's share of mineral royalties last year, including those paid on coal and sodium in addition to oil, amounted to $95 million. By 1985, Wyoming is expected to receive $250 million due to the rising price and production of oil There is no question that with rising oil prices, royalty funds are becoming extremely important to the producing States, particularly those who will suffer the impact of development of new sources of oil and gas.

Consequently, it is nothing short of apalling to find that a State like Wyoming and Indian tribes are being and have been shortchanged by the Federal Government due primarily to accounting problems in addition to isolated incidents of outright theft. The figures for Wyoming are particularly shocking since this State is the largest producer of Federal onshore oil in the Nation. Figures differ, but it has been calculated by some that Wyoming alone may have been shortchanged by as much as $80 to $200 million in oil and gas royalties over the last 6 years. It is a situation which we obviously cannot—pardon the pun—afford much less tolerate.

That is why we are here today as concerned citizens and representatives of those who have a stake in this matter. We want to know what is being done about this. The problem we'll be discussing is dual in nature. It is one of accounting as well as one of security. The latter, lack of adequate security resulting in theft, is in part tied to the former.

It was the theft situation which really focused national attention on the accounting mess. The idea of people stealing oil is reprehensible, and those guilty of the theft are quite rightly being prosecuted as a result of a Federal grand jury investigation. The theft situation is very serious and certainly the security problem must be cured. My good friend, John Melcher, has been active in research of that issue. I welcome his attendance at this hearing. He is on his way down here I understand from the airport.

But today I want to direct our attention to the accounting aspect of the problem because it is equally as serious. The accounting system has had problems that go back in time as far as the fifties. The old system managed to limp along for as long as it did presumably because with oil priced at less than $2 per barrel, it was felt that the cost to update it was not outweighed by the royalties to be gained. That has drastically changed. It is claimed that 10 percent of all mineral royalties aren't being collected due to obsolete and inefficient accounting procedures. Ten percent adds up to an enormous amount of money at today's oil prices.

The administration promised to streamline and otherwise make the Federal bureaucracy more efficient. I must say I can think of no better place to begin than here. There has been too much time spent in tinkering with quick fixes that don't work. It is time to get down to business and see that a good system is put into place. If we don't we are in effect only going to cure symptoms when what we need to do is wipe out the disease.

We have a number of witnesses and panels coming before us this afternoon. I would ask in advance if all witnesses could summarize the salient points of their testimony. The entire written statement of each witness will be placed in the record as it's delivered, and those wishing copies of the printed record should put their names and addresses on the list on the table by the sign which is yonder over in the corner.

The hearing record will remain open for 2 weeks after today for additional written statements and they can be sent to my office in Casper or directly to the Senate Energy and Natural Resources Committee, 3106 Dirkson Senate Office Building, Washington, D.C., 20510, attention Tony Bevinetto.

In closing, before we get on with this hearing, I would like to say that I'm very encouraged by the appointment of the blue ribbon commission headed up by David Linowes. It is my understanding that the commission has 6 months to pinpoint shortcomings and recommend solutions in the royalty accounting procedures. That being the case, I understand that we cannot expect to have complete answers today. Nevertheless, as we all have a stake in what the commission comes up with, we are most anxious to be included and to hear where we stand. With that, let us get on with the hearing and welcome Senator Melcher; glad you are here John.

STATEMENT OF HON. JOHN MELCHER, A U.S. SENATOR FROM THE STATE OF MONTANA

Senator MELCHER: Thank you very much, Malcolm. I'm glad you called this hearing. It's about time that we get the Senate Energy Committee and the activities of the Select Committee on Indian Affairs in the Senate dovetailed together. And this hearing is extremely timely to do that.

We've been having hearings and investigations on what happens on Indian leases throughout the country for the past 8 or 9 months beginning in late 1980 just after the Wind River thefts were reported. However, the focus of your hearings here is whether the oil royalty accounting system of the Geological Survey is going to be effective in the oil fields both on Indian and Federal leases.

I think that now with the appointment of the blue ribbon panel by Secretary Watt and the dovetailing of what the Indian Affairs Committee has been doing in the Senate and what the Energy Committee's responsibility is, that we're going to see some pretty fast and prompt action.

I'm delighted. It's about time that we take the steps that are necessary to clean up the mess that does exist. The question is whether or not we have the proper basic guidelines laid out by the Geological Survey to even start with a proper accounting system.

I don't think you can have a real good royalty accounting system until you have the Conservation Division of GS on the ball and enforcing their own regulations in the oil fields. When that happens, and when we get a new royalty accounting system, I think everybody in this country will be a lot happier. I think we will take away the stigma that now exists in a very fine professional group, the Geological Survey. It is important that GS enforce regulations properly and account for the oil that is produced; it goes without saying that this includes the natural gas that is produced on Indian and Federal leases.

Also I think this hearing also provides a framework for a better understanding on all accounting for oil and gas production in this country whether it's Indian, Federal, or private.

I welcome that because the practices that have grown up over the past four or five decades in the oilfield and in the gasfield aren't ones that entirely lend themselves to the complete confidence of the public in the transfer and the accounting procedures.

Malcolm, I congratulate you on scheduling this hearing. I think Casper, Wyo., is a proper place for it. I can't imagine a better place to have it because it really is the hub of a great deal of activity that's now going on with oil and gas production, both Indian and Federal as well as private and will continue to be an expanding area.

Senator WALLOP. John, thank you. And I place in the record a statement by Senator Simpson at this point.

[The prepared statement of Senator Simpson follows:

STATEMENT OF HON. ALAN K. SIMPSON, A U.S. SENATOR FROM THE STATE OF WYOMING

Mr. Chairman and my neighbor Sen. John Melcher of Montana, I am most pleased to have this opportunity to offer remarks concerning recent activities in the area of petroleum production and accounting procedures on Federal lands. The inefficiencies and difficulties that brought about a breakdown in the Federal oil royalty accounting system are very serious. Each and every party involved in oil production and royalty accounting stands to lose something when we observe these failures in the system. All of the royalty owners: Indian tribes, State and local governments, and the Federal Government suffer the consequences resulting from mismanagement and lack of coordination and cooperation.

The Federal Government has the primary responsibility to the citizens of this country to oversee and regulate the accounting, collection and distribution of royalties derived from mineral production on Federal lands. The Reagan administration and Secretary of the Interior, James Watt, have recognized this responsibility and have begun to implement significant policy changes. The difficulties in royalty management and accounting have come about for a number of reasons, including an inadequate number of inspectors and accountants, and a flawed accounting system.

The serious allegations of waste and revenue loss resulting from inadequate accounting of America's energy resources have been of great concern to Secretary Watt. The Secretary realizes that the Interior Department, the Congress, the General Accounting Office, the Indian Community, the State governments and taxpayers that share in oil and gas revenues have all had a degree of concern about past accounting deficiencies. . . . Yet little has been done to correct these deficiencies. In order to correct this lack of action, Secretary Watt recently announced the establishment of a commission of fiscal accountability of the Nation's energy resources to develop solutions to minerals management problems. This commission will focus on royalty accounting and oil theft and will review all current and proposed departmental efforts to assure that they provide effective solutions to the problems. I see this measure as the first substantial effort by the Department of the Interior to correct the deficiencies of the past.

This five-member Commission will be chaired by David F. Linowes, an international authority in accounting and auditing procedures.

The Commission is also made up of distinguished accounting and administrative authorities. The Secretary of the Interior has directed this special Commission to review the Department's mineral royalty accounting system—to recommend ways of improving it—as well as to design methods of preventing the theft of oil from Indian reservation and other Federal producing lands.

Jim Watt is dedicated to rooting out and eliminating waste and fraud throughout the Department of the Interior and he is aware that the inherited problems of mineral accounting and oil theft are two of the most serious facing his Department.

By establishing the Special Commission on Fiscal Accountability of the Nation's Energy Resources, the Secretary has again demonstrated that he has a genuine interest in sound and reasonable management practices. The panel of experts selected will make a major contribution not only to better government, but to assuring correct receipt of revenues for the Government, Indian tribes and States.

Mr. Chairman, your hearing today is a very important part of the process. I certainly commend you for your diligence and look forward to working with you, Sen. Melcher and our colleagues in devising a solution.

Senator WALLOP. Our first witness who is chairing a meeting of the State Oil and Gas Conservation Committeee across the hall is Mr. Oscar Swan, State land commissioner for Wyoming, And we'll put you on the stand, Oscar. Welcome here.

Mr. SWAN. Thank you. Senator Wallop, Senator Melcher, Governor Herschler could not be here. He's attending the National Governor's Conference. And his statement is a summary. We may wish to supplement it. And if I may, I'll get right with it.

Senator WALLOP. By all means.

STATEMENT OF HON. ED HERSCHLER, GOVERNOR, STATE OF WYOMING AS PRESENTED BY OSCAR SWAN, STATE LAND COMMISSIONER FOR WYOMING

Mr. SWAN. This problem we have is the problem that each of the Western States shares with the Federal Government, and it will only be solved with our cooperative efforts and the existence of this problem is beyond dispute. In fact, I accept the estimates of the General Accounting Office as to its magnitude and address today the things the Congress, the Department of the Interior, and the States and their agencies can do to help solve the problem.

The Western States Land Commissioners at their recent meeting in Oklahoma adopted three resolutions directed at this problem. I don't have this yet in final form. You will receive official copies very shortly, and I ask that they each be considered as part of the record in this hearing.

The first of these resolutions expresses appreciation for Secretary Watt's willingness to recognize the problem with which we are concerned and to do something about it. It urges the Secretary to request the Congress to appropriate adequate funds to get the job done. Gentlemen, we won't solve this problem by just throwing money at it; but we won't solve it without adequate manpower and funds to employ it. This is one of those situations where you have to spend money to make money. If you spend it wisely, every dollar you spend will be repaid several times over.

The second resolution reminds Secretary Watt that each of the States sharing in Federal royalties from on-shore production has State agencies which collect the State's royalties, collect taxes on mineral production, and maintain records and status on mineral production for conservation and other purposes. It offers him their cooperation and the benefit of their experience and expertise. It suggests that at least one member of the blue ribbon panel Secretary Watt has appointed to study this problem should come from one of the State agencies. I concur in this recommendation.

The third resolution supports Senator Wallop's bill which would repeal that part of the Windfall Profits Tax Act which applies to the royalties on oil produced from federally owned onshore land. This has more to do with securing accurate accounting for auditing and distribution of the Federal royalties than appears at first glance.

The provision of the Windfall Profits Tax Act which applies it to the Feddral royalties is a scam by which the Federal Government pretends to tax itself in order ot take away from the States money Congress promised them.

Our State treasurer, Mrs. Shirley Wittler, tells me she can't find out how much the State is losing; but she is confident that if the taxes continued in effect on Federal royalties and we can ever find out what really happened to us, Wyoming's loss alone will prove to have been staggering—many millions annually.

To add insult to injury, the Federal Government will take this money which the State would have used to litigate impact and use it to build synfuel plants to create more impact.

The reason she can't find out is nobody knows. Devious legislative schemes have a way of producing unintended and untoward results. This one is no exception. It makes the Department of the Interior's task of collecting, accounting for, auditing, and distributing Federal mineral royalties completely impossible instead of just extremely difficult. It will be too confused trying to figure out how the tax applies to the royalties that is reported to it. It can never determine whether the royalties themselves have been properly reported or distributed.

We think the loss to the Federal Government will exceed what it takes away from this State by the windfall profits tax. This means the Federal Government won't profit, and the State's loss will be more than doubled.

As long as this tax provision remains in effect, none of the other measures I suggest or that anyone else may suggest will be completely effective. They should still be considered.

When a task becomes too big and complicated that it's impossible, sometimes it can be accomplished by breaking it down into a number of smaller tasks. It also helps to assign each of those individual smaller tasks to different people.

Federal legislation could—would allow the Secretary of the Interior to enter into contracts with the individual States by which each State could assume all or a substantial part of the accounting for, auditing, and distribution of Federal royalties on minerals produced in that State is essential if the State and the Federal Government are to avoid wasteful duplication of effort and wasteful competition for the limited number of persons fully qualified to perform this exacting work. Enabling State legislation will probably be necessary in most States as well.

The Federal law and the laws of the individual States should not merly permit—they should require prompt, free, and full exchangee of information upon the request of either the Federal or the State agencies.

These laws should also provide means by which the Federal and State agencies could require reports or secure information upon which from each person having custody of oil, gas, or any other mineral from the producer through each transporter to the refiner, processor, or industrial consumer. They should also establish a right to audit any such person. A person having custody of oil or other minerals being transported or stored should be required to have and present adequate documentation to the proper authority.

Both the Federal laws and regulations and the State laws and regulations should provide for adequate penalties. As matters now stand, too many producers tend to view their obligations to pay royalties in somewhat the same way as they view their obligation to pay income tax. Application of the windfall profits tax to Federal royalties will make this unfortunate attitude more prevalent. They will report and pay as little as they think they can get away with. Their diligence in reporting accurately will be determined by the penalty imposed on them if they are caught.

In the case of the income tax, the penalties are sufficient and the accounting or auditing adequate to insure that deliberate evasion is minimized. In the case of royalty payments, if a producer gets caught, he usually pays what he owes plus interest at a rate below that the producer actually earned and the royalty owner could have earned by investing the funds. This is a disincentive rather than an incentive to prompt an accurate reporting of royalties by the producer. We need realistic penalties for failure to report Federal and State royalties accurately and pay them promptly.

Legislation rewarding informers who find unpaid royalties similar to tax ferret and informer statutes which the IRS in some States has should also be considered.

The Connally Hot Oil Act might be reviewed to see if a revision of its definition of hot oil to include oil produced from Federal, State, or Indian lands for which a proper accounting has not been made would be of any help.

Senator Wallop and Senator Melcher, I thank you again for this opportunity. I've given you a pretty good laundry list of Federal legislation which I think will help solve our mutual problem. Most of these measures will require a companion State legislation. I offer my personal support and assistance, and that of our State agencies in any effort to secure the drafting and enactment of any of the Federal legislations I recommended. I assure you that I will recommend to our State legislature the enactment of necessary companion State legislation.

The Department of the Interior may also be assured that it will have the full cooperation of Mr. Griffith, Wyoming's State auditor, and any other State agency which can be of assistance to it in its effort to make sure that the royalties due on all Federal mineral leases are fully collected, accurately accounted for, and properly distributed.

Gentlemen, that concludes the Governor's statement. I don't know whether I can answer any questions you might have asked him, but I'll sure try if you have any.

[Subsequent to the hearing Mr. Swan submitted the following resolutions:]

THE STATE OF WYOMING

Commissioner of Public Lands and Farm Loans

2424 PIONEER AVENUE
PIONEER BUILDING

CHEYENNE, WYOMING 82002

November 23, 1981

PLEASE ADDRESS REPLY
TO THE COMMISSIONER

Energy & Natural Resources Committee
Attn: Tony Bevinetto
Dirksen S.O.B. - Rm. 3204
Washington, DC 20510

Gentlemen:

The enclosed copies of resolutions adopted by the Western States Land Commissioners Association at its July 25th meeting in Oklahoma will complete the testimony of Governor Ed Herschler before the Public Land and Reserved Water Sub-committee given last summer in Casper, Wyoming.

I apologize for the delay in transmiting these documents to you, but they were not received in this office until today.

Yours sincerely,

Oscar E. Swan
OSCAR E. SWAN
COMMISSIONER OF PUBLIC LANDS

OES:ekh

Attachment

cc: Governor Ed Herschler

THE WESTERN STATES
LAND COMMISSIONERS ASSOCIATION

Alaska
Arizona
California
Colorado
Hawaii
Idaho
Louisiana
Montana
Nebraska
Nevada
New Mexico
North Dakota
Oklahoma
Oregon
South Dakota
Texas
Utah
Washington
Wisconsin
Wyoming

1807 - 13th Street
Sacramento, California
95814

November 16, 1981

Mr. Oscar E. Swan
Commissioner of Public Lands
and Farm Loans
2424 Pioneer Avenue
Pioneer Building
Cheyenne, Wyoming 82002

Dear Oscar:

At long last, I am attaching copies of resolutions adopted by the Western States Land Commissioners Association at its July 25 meeting in Shangri-La, Oklahoma. Copies of the resolutions are also being sent to the appropriate public officials and congressional committees.

See you all at the midwinter meeting in Washington, D.C.!

Sincerely,

Bill

WILLIAM F. NORTHROP
Secretary

WFN/rb

Attachments

THE WESTERN STATES
LAND COMMISSIONERS ASSOCIATION

Alaska
Arizona
California
Colorado
Hawaii
Idaho
Louisiana
Montana
Nebraska
Nevada
New Mexico
North Dakota
Oklahoma
Oregon
South Dakota
Texas
Utah
Washington
Wisconsin
Wyoming

RESOLUTION #1

EXEMPTING THE STATE SHARE OF FEDERAL OIL ROYALTIES FROM THE WINDFALL PROFIT TAX

WHEREAS, the Crude Oil Windfall Profit Tax Act of 1980 has been interpreted to apply the tax to the states' 50% share of federal oil royalties; and

WHEREAS, this interpretation is contrary to the expressed intent of Congress in exempting state royalty oil from the tax; and

WHEREAS, this interpretation allows the federal government to retain far more than 50% and causes the states to receive far less than 50% of the federal oil royalties, in direct contravention of the Mineral Leasing Act of 1920, which provides that 50% of the royalties received from leases issued under these acts shall be paid to the states from which the mineral or resource is produced; and

WHEREAS, this unintended, and severe reduction of the income received by the states adversely affects their ability to offset the impacts of federal land ownership upon the states and their citizens; and

WHEREAS, Senator Wallop has introduced in Congress, Senate Bill 700 which would eliminate this interpretation and its unjust result by exempting the state share of federal oil royalties from the Windfall Profit Tax; now therefore, be it

RESOLVED, that the Western States Land Commissioners Association urges the Congress of the United States to enact S. B. 700 without further delay; and be it further

RESOLVED, that a copy of this Resolution be sent to all members of Congress, to the President of the United States, and the Secretary of the Treasury.

ADOPTED this 30th day of July, 1981.

FOR THE WESTERN STATES LAND
COMMISSIONERS ASSOCIATION

Rowena Rogers
President

Secretary

THE WESTERN STATES
LAND COMMISSIONERS ASSOCIATION

Alaska
Arizona
California
Colorado
Hawaii
Idaho
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Montana
Nebraska
Nevada
New Mexico
North Dakota
Oklahoma
Oregon
South Dakota
Texas
Utah
Washington
Wisconsin
Wyoming

RESOLUTION #2

LANDS & REALTY AND CADASTRAL SURVEY

WHEREAS, the Western States are entitled to 600,000 acres of public land to satisfy their school land grants; and

WHEREAS, many of the school lands received in place are scattered, intermingled sections within the public domain, National Forests, National Parks, defense installations, Indian reservations, or other Federal enclaves; and

WHEREAS, it is in the national and state interest to block up these lands while simultaneously blocking up federal ownerships into cohesive units capable of efficient management; and

WHEREAS, the satisfaction of remaining state school land entitlement and completion of exchanges to organize effective land management units are dependent on there being available sufficient resources to the Bureau of Land Management's Lands & Realty and Cadastral Survey programs; and

WHEREAS, these programs have received some augmentation in recent budgets, but remain unfunded to the degree necessary to move promptly to complete state indemnity selection processing and process exchanges in a timely manner; now therefore, be it

RESOLVED, that the Western States Land Commissioners Association urges the Secretary of the Interior to provide the Bureau of Land Management with the appropriate positions and funds needed to process on a current basis, the satisfaction of state school land indemnity entitlement and the exchanges of interests needed to block up federal and state land holdings; and be it further

RESOLVED, that the Secretary of the Association send a copy of this Resolution to the Members of Congress on the appropriate committees, to the Secretary of the Interior, to the Director of the Office of Management and Budget, and to the Director of the Bureau of Land Management.

ADOPTED this 30th day of July, 1981.

FOR THE WESTERN STATES LAND
COMMISSIONERS ASSOCIATION

Rowena Rogers
President

Secretary

THE WESTERN STATES
LAND COMMISSIONERS ASSOCIATION

Alaska Arizona California Colorado Hawaii Idaho Louisiana Montana Nebraska Nevada New Mexico North Dakota Oklahoma Oregon South Dakota Texas Utah Washington Wisconsin Wyoming

RESOLUTION #3

SECRETARY WATT, TO CONTINUE "GOOD NEIGHBOR" POLICY

WHEREAS, the appointment of James Watt to the position of Secretary of the Interior has dramatically changed the philosophy and the direction of the Department; and

WHEREAS, reality, reasonableness, and responsibility, are reflected in these changes; and

WHEREAS, the Western States Land Commissioners Association is fully aware of how difficult it may be to have changes filter down to the local level; and

WHEREAS, the desire to improve the federal-state relationship is the goal of all involved entities; now therefore, be it

RESOLVED, that Secretary Watt be encouraged to continue, with sound environmental constraints, in his efforts to "be a good neighbor"; and that the Western States Land Commissioners Association pledges to accept the responsibility of assisting in the effort to make the states and the federal government true "partners" in the western land issues.

ADOPTED this 30th day of July, 1981.

FOR THE WESTERN STATES LAND
COMMISSIONERS ASSOCIATION

Rowena Rogers
President

Secretary

THE WESTERN STATES
LAND COMMISSIONERS ASSOCIATION

Alaska
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Montana
Nebraska
Nevada
New Mexico
North Dakota
Oklahoma
Oregon
South Dakota
Texas
Utah
Washington
Wisconsin
Wyoming

RESOLUTION #4

GRANTS OF PUBLIC LAND FOR SMALL URBAN COMMUNITIES

WHEREAS, there are many small urban communities in the public land states that are surrounded by federal land; and

WHEREAS, the energy and mineral crisis has created excessive demands for land to allow for expansion; and

WHEREAS, the lack of this needed land for expansion has created artificially high values on existing land that is available for housing and commercial development; and

WHEREAS, existing statutes only allow the federal land at issue to be sold at appraised values and these appraised values are inflated primarily due to the unavailability of these said federal lands; now therefore, be it

RESOLVED, that the Western States Land Commissioners Association does hereby urge Bureau of Land Management Director, Robert Burford, and Secretary of the Interior, James Watt, to ask the Congress of the United States to pass an alternate method, or methods to resolve a serious western fiscal problem that is being unnecessarily created by the federal ownership of lands around expanding communities.

ADOPTED this 30th day of July, 1981.

FOR THE WESTERN STATES LAND
COMMISSIONERS ASSOCIATION

President

Secretary

THE WESTERN STATES
LAND COMMISSIONERS ASSOCIATION

Alaska
Arizona
California
Colorado
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Louisiana
Montana
Nebraska
Nevada
New Mexico
North Dakota
Oklahoma
Oregon
South Dakota
Texas
Utah
Washington
Wisconsin
Wyoming

RESOLUTION #5

ON APPOINTMENT OF A WESTERN STATE LAND COMMISSIONER TO THE COMMISSION ON FISCAL ACCOUNTABILITY OF THE NATION'S ENERGY RESOURCES

WHEREAS, the General Accounting Office of the Congress has highlighted the continuing problem of properly collecting and accounting for royalties on minerals produced from the federal public lands; and

WHEREAS, the Secretary of the Interior has recognized the immediate need to correct this problem and has established a Commission on Fiscal Accountability of the Nation's Energy Resources; and

WHEREAS, under the Mineral Leasing Act of 1920, and the Geothermal Steam Act, 50% of the royalties received from leases issued under these acts shall be paid to the states; and

WHEREAS, in each of the member states of the Western States Land Commissioners Association, state agencies are collecting royalties on minerals produced from state lands, taxes on mineral production, and oil and gas production data for conservation purposes; and

WHEREAS, their expertise should be made available to the Department of the Interior and to the Commission appointed by the Secretary; and

WHEREAS, cooperation and full exchange of information between the state and federal agencies is essential to avoid needless and inefficient duplication of effort and to achieve maximum efficiency in collecting and accounting for royalties; now therefore, be it

RESOLVED, that the Western States Land Commissioners Association urges the Secretary of the Interior to take advantage of this expertise in the western states; and be it further

RESOLVED, that the Secretary be requested to appoint a member of the Association to the Commission; and be it further

RESOLVED, that the Secretary of the Association send a copy of this Resolution to the Secretary of the Interior, the Director of the Geological Survey, the Director of the Bureau of Land Management, and to the Governors of the member states.

ADOPTED this 30th day of July, 1981.

FOR THE WESTERN STATES LAND
COMMISSIONERS ASSOCIATION

Rowena Rogers
President

Secretary

THE WESTERN STATES
LAND COMMISSIONERS ASSOCIATION

Alaska
Arizona
California
Colorado
Hawaii
Idaho
Louisiana
Montana
Nebraska
Nevada
New Mexico
North Dakota
Oklahoma
Oregon
South Dakota
Texas
Utah
Washington
Wisconsin
Wyoming

RESOLUTION #6

ROYALTY ACCOUNTING PROBLEMS ON FEDERAL MINERAL LEASES

WHEREAS, an estimated 80% of the mineral resources of the United States are located in the western states represented in the Western States Land Commissioners Association; and

WHEREAS, in 1980 federal revenues from onshore oil alone are expected to be 378 million dollars, and are expected to double between 1980 and 1984; and

WHEREAS, it is conservatively estimated by the General Accounting Office and the United States Geological Survey that 10% of these revenues are being lost through poor federal management; and

WHEREAS, the Mineral Leasing Act of 1920, and the Geothermal Steam Act of 1970, provide that 50% of the federal revenues from mineral and geothermal resources should go to the state from which they are taken; and

WHEREAS, the Secretary of the Interior has recognized the serious loss in revenues to federal and state governments alike in the Department's failure to collect mineral royalties due, and appointed a Commission on Fiscal Accountability of the Nation's Energy Resources to consider the problem and make recommendations; now therefore, be it

RESOLVED, that the Western States Land Commissioners Association respectfully urges that the Secretary and Commission meet and confer with it and its members to determine ways and means of improving federal royalty collections; and be it further

RESOLVED, that the Secretary be requested to conduct a meaningful and adequately staffed audit to determine and recover past underpayments made on all federal mineral leases; and be it further

RESOLVED, that the Secretary be urged to seek, and Congress to appropriate, supplemental appropriations in an amount sufficient to permit the Department of the Interior to conduct immediate audits, field inspections, and accountings adequate for the full collection of mineral revenues from the public lands; and be it further

RESOLVED, that the Secretary of the Association send a copy of this resolution to the Secretary of the Interior, the Director of the Geological Survey and the Chairman of the Commission on Fiscal Accountability of the Nation's Energy Resources.

ADOPTED this 30th day of July, 1981.

FOR THE WESTERN STATES LAND
COMMISSIONERS ASSOCIATION

Rowena Rogers
President

Secretary

THE WESTERN STATES
LAND COMMISSIONERS ASSOCIATION

Alaska *Hawaii* *Nebraska* *Oklahoma* *Utah*
Arizona *Idaho* *Nevada* *Oregon* *Washington*
California *Louisiana* *New Mexico* *South Dakota* *Wisconsin*
Colorado *Montana* *North Dakota* *Texas* *Wyoming*

RESOLUTION #7

APPRECIATION OF OKLAHOMA AS THE HOST STATE

WHEREAS, the Western States Land Commissioners Association, meeting in the great State of Oklahoma, were treated to an excellent conference hosted by the Commissioners of the Land Office; and

WHEREAS, Oklahoma arranged for the Association to use the facilities of beautiful Shangri-la Resort on the Grand Land o' the Cherokees; and

WHEREAS, Oklahoma prepared an exciting and informative program for the Commissioners, their staff and guests; and

WHEREAS, Oklahoma did outdo themselves in the hospitality afforded the Association and were gracious and friendly hosts; now therefore, be it

RESOLVED, that the Western States Land Commissioners Association expresses its sincere appreciation for the fine hospitality and excellent program put on by Oklahoma for the 1981 annual conference; and be it further

RESOLVED, that the Association thanks Governor George Nigh, Lieutenant Governor Spencer Bernard and State Auditor/Inspector Tom Daxon for personally appearing and sharing with the Association; and be it further

RESOLVED, that Secretary W. R. Massey, Assistant Secretary Carol Ford and all the great staff of the Land Office be given the highest esteem of the Association for their hard work in putting on the Conference; and be it further

RESOLVED, that the Secretary send a copy of this resolution to Governor Nigh, Lt. Governor Bernard, Auditor Daxon and Secretary Massey.

ADOPTED this 30th day of July, 1981.

FOR THE WESTERN STATES LAND
COMMISSIONERS ASSOCIATION

President

Secretary

THE WESTERN STATES
LAND COMMISSIONERS ASSOCIATION

Alaska
Arizona
California
Colorado
Hawaii
Idaho
Louisiana
Montana
Nebraska
Nevada
New Mexico
North Dakota
Oklahoma
Oregon
South Dakota
Texas
Utah
Washington
Wisconsin
Wyoming

RESOLUTION #8

NET PROFITS INTERESTS UNDER THE WINDFALL PROFIT TAX ACT

WHEREAS, the Congress enacted in 1980 the Windfall Profit Tax Act; and

WHEREAS, it was the intent of Congress that state and other public interests in oil were to be exempt from the provisions of the Act; and

WHEREAS, Section 4994(a) of the Windfall Profit Tax Act does exempt, explicitly, the oil interests of states from payment of the tax; and

WHEREAS, interpretations of the Act by the Department of the Treasury have caused the tax to be applied to the state-owned oil where net profits type agreements exist; and

WHEREAS, this interpretation, based on income tax law terms, is inapplicable, and an unintended application of the Windfall Profit Tax Act; and

WHEREAS, Senators Hayakawa and Cranston have introduced Senate Bill 753, and Representative Glenn Anderson introduced House Resolution 3044 which, when enacted would correct this problem; and

WHEREAS, the Department of the Treasury has indicated its support of these bills to clarify the Act; now therefore, be it

RESOLVED, that the Western States Land Commissioners Association supports the provisions of S. B. 753 and H. R. 3044 and encourages their passage; and be it further

RESOLVED, that the Association urges the Senate and House of Representatives to take prompt action to relieve the states from the burden of paying the tax on state-owned oil; and be it further

RESOLVED, that the Secretary of the Association send a copy of this Resolution to the Members of Congress from the member states, to the Secretary of the Treasury, and to the Secretary of the Interior.

ADOPTED this 30th day of July, 1981.

FOR THE WESTERN STATES LAND
COMMISSIONERS ASSOCIATION

Rowena Rogers
President

Secretary

Senator WALLOP. John, do you have any?

Senator MELCHER. No, I do not have any questions. I want to compliment you, Mr. Swan, on presenting Governor Herschler's statement. I think it's a very good statement. The Governor lays groundwork for us to do in terms of Federal legislation, but I think it's absolutely essential that we work with States like Wyoming, my own State of Montana, and officials that know something about these problems so that, dovetailing together, that we get something done.

Mr. SWAN. Well, it is obviously a summary. If we can pad it out, you just let us know what you want.

Senator WALLOP. And we will certainly take you up on your sugesttion. If you want to pad it out, do so by all means. The hearing record as I said would be open for 2 weeks. Let me just ask you one question. Is there any coordination mechanism that either exists or that should exist between the State and the USGS with regards to accounting?

Mr. SWAN. Yes there is. Mr. Griffith, I think, is going to touch on that. He and I have been meeting with them, and quite frankly we are encouraged. We think there will be cooperation.

Senator WALLOP. Well, I'll wait then. I much appreciate your time here, and I hope the folks across the hall will understand your presence was needed.

Mr. SWAN. Thank you. They'll appreciate it

Senator WALLOP. Thank you. Now, the next witness is Mr. John Simonette, General Accounting Office which has made quite a study of this issue. He will be accompanied by Mr. Jeffrey C. Steinhoff, senior group director, Accounting and Financial Management Division, General Accounting Office; and Darby Smith, senior accountant, Denver office; and Glen L. Baughman, supervisory auditor. Welcome, gentlemen, and proceed.

STATEMENT OF JOHN F. SIMONETTE, ASSOCIATE DIRECTOR, ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY JEFFREY C. STEINHOFF, SENIOR GROUP DIRECTOR, ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION; DARBY SMITH, SENIOR ACCOUNTANT, DENVER OFFICE; AND GLEN L. BAUGHMAN, SUPERVISORY AUDITOR

Mr. SIMONETTE. Thank you. Good afternoon, Senator Wallop, and Senator Melcher. We're pleased to be here today to discuss a review of Geological Survery's oil and gas royalty collection system—a system fraught with longstanding problems. As you probably know, we issued a report in 1979 in which we identified serious financial management problems with the collection and accounting for oil and gas royalties off of Federal and Indian lands. On the basis of more recent work for the Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Government Operations, we have determined that these problems persist.

Geological Survey is not collecting all oil and gas royalties; and, as a result, hundreds of millions of dollars may be going uncollected each year. Moreover, millions of dollars in royalty income are not collected when due, thus increasing the Government's interest cost. Until

Geological Survey improves its financial management, there can be little assurance that all royalty income due from Federal and Indian lands is received.

We recognize that Geological Survey's past is complex and that it has had to deal with many factors beyond its control such as the proliferation of lease interests, varying royalty rates, and complex oil and gas valuation factors. Moreover, the monetary amounts Geological Survey is responsible for has grown tremendously in recent years. Geological Survey is seeking to improve its financial management capabilities by developing a new royalty accounting system. Also we are very encouraged by Secretary Watt's establishment of the Commission on Fiscal Accountability of the Nation's energy resources, which you earlier referred to.

Since 1959 in numerous General Accounting Office and Department of Interior audit reports have pointed out the need to improve management of Geological Survey's royalty collection system. For example, in our April 1979 report we noted that Geological Survey was not collecting all the oil and gas royalty income due it because leased account records contained numerous errors and omissions, unverified data was used to compute royalties, and collection procedures were inadequate.

Although Geological Survey has sought to respond to some of the recommendations contained in our report, management problems persist.

In our 1979 report we stated that Geological Survey's lease account records contained numerous errors and data omissions and could not be relied on to determine the accuracy of royalty collections. As a result, Geological Survey in the oil and gas industry cannot use these records to determine if royalties were properly computed and paid. On the basis of recent followup work we have determined that lease accounts are still inaccurate. As of September 1980, over 19, 000 or about 73 percent of Geological Survey's some 26, 000 lease accounts had a balance which indicated that some problems still existed with these accounts. Because of the incomplete and inaccurate data entered into lease accounts, account statements could not be used to adequately manage royalty collections.

Moreover, Geological Survey relies almost entirely on unverified production and sales data reported by oil and gas companies to compute royalty payments due. It makes—it makes little effort to verify the accuracy of the data supply.

In fiscal 1980 Geological Survey audited only 5 percent of its lease accounts; although, past audits have proven beneficial. For example, as discussed in our 1979 report, Geological Survey's Metairie, La., office completed eight audits during the 9 month period ending September 30, 1978. These audits yielded about $7. 5 million in additional Federal royalty income.

In addition to auditing, GS could reduce its reliance on unverified data by matching reported production data against reported sales data. By doing so it could identify potential serious data inconsistencies which indicate possible royalty payment shortfalls. Moreover, this approach could be further defined by having Geological Survey personnel who periodically inspect wellsites verify reported production data. However, better data verification procedures alone will not resolve all of the agency's financial management problems. It also needs to develop a viable royalty accounting system which will assure that information reported is properly accounted for and that necessary controls are in place to insure the accurate and complete reporting of royalties.

Also, as noted in our prior report, GS was not receiving timely payments of royalties in 1977. Late payments amounted to approximately $359 million. These payments were not received within the timeframe specified in leases because GS did not adequately enforce lease provisions calling for timely payment of royalties, and did not impose appropriate administrative fees or interest charges on those making late payments.

Based on our analysis of 275 lease accounts for the 3 months ending June 30, 1980, we project that late payments totaled $98 million for the quarter alone. Had these delinquent papers been assessed interest charges equal to the cost of Federal borrowing, they would have owed an additional $400,000 for the 3-month period alone. Unfortunately, GS did not take timely action on this problem despite our earlier report.

In our 1979 report we cited evidence indicating that the GS may not have been collecting as much as 7 to 10 percent of the royalties owed the Federal Government. This—the only such estimate we are aware of is based on the experience of a private oil and gas company which audits oil and gas leases.

Currently GS by its own admission is not collecting over $1 million per day in royalties.

Geological Survey, recognizing that its accounting system was inadequate, formed a task force in October 1978, to recommend system improvements. In December 1978, the task force recommended that a new royalty accounting system be designed and implemented. That system is not yet operational and will not be fully operational for several years.

Geological Survey completed a feasibility study and cost-benefit analysis for a new system in March 1981. It plans to award a contract for design of the now system in September 1981, The system will be implemented in three phases over a 5-year period. The three phases consist of (1) the royalty accounting phase, (2) the production phase, which will permit the matching of production and sales data, and (3) the enhanced management phase which will center on developing quality review and management data.

GS currently estimates that the royalty accounting phase will be fully implemented in fiscal 1983, and the production phase by fiscal 1984, If the system is effective, GS should be able to better account for and control royalty payments. Until then, however, it seems that GS will be hard pressed to fully carry out its royalty collection responsibility.

Geological Survey does not plan to transfer existing account balances into the new royalty accounting system. Thus, besides actively working to develop a new system, Geological Survey also has to develop a plan for reconciling old accounts and identifying and collecting previously uncollected royalties.

In June 1981, Geological Survey announced that it plans to audit the 20 to 25 largest oil and gas companies which account for over 89 percent of the royalties due. To assure that all royalties are being paid promptly, it is imperative that a long-term program be developed to provide for periodic auditing of lease accounts.

In closing we would like to emphasize that the problems discussed above can only be corrected through a sustained high priority effort—one with long-term prompt management involvement.

This concludes my statement. I will be happy to respond to any questions that you may have.

[The prepared statement of Mr. Simonette follows:]

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
Expected at 2:00 p.m.
Tuesday, August 11, 1981

STATEMENT OF
JOHN F. SIMONETTE
ASSOCIATE DIRECTOR
ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION
BEFORE THE
SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES
ON GEOLOGICAL SURVEY'S OIL AND GAS ROYALTY COLLECTION SYSTEM

Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss our review of Geological Survey's oil and gas royalty collection system--a system fraught with longstanding problems. Geological Survey is responsible for collecting the royalty income derived from oil and gas produced on Federal and Indian lands. Royalty collections have increased rapidly in recent years primarily because of substantial increases in oil and gas prices. Annual royalties are expected to be $4 billion in fiscal 1982 and could grow to $22 billion by fiscal 1990.

In our 1979 report entitled "Oil and Gas Royalty Collections--Serious Financial Management Problems Need Congressional Attention" (FGMSD-79-24, Apr. 13, 1979), we pointed out that Geological Survey was having great difficulty in accounting for and collecting Federal royalty income. On the basis of more recent work for the Subcommittee on Commerce, Consumer, and Monetary Affairs, House Committee on Government Operations, we have determined that these problems persist.

Geological Survey is not collecting all oil and gas royalties and, as a result, hundreds of millions of dollars may be going uncollected each year. Moreover, millions of dollars in royalty income are not collected when due, thus increasing the Government's interest costs. Until Geological Survey improves its financial management, there can be little assurance that all royalty income due from Federal and Indian lands is received.

We recognize that Geological Survey's task is complex and that it has had to deal with many factors beyond its control such as the proliferation of lease interests, varying royalty rates, and complex oil and gas valuation factors. Moreover, the monetary amounts Geological Survey is responsible for have grown tremendously in recent years.

Geological Survey is seeking to improve its financial management capabilities by developing a new royalty accounting system. Also, we are very encouraged by Secretary Watt's establishment of the Commission on Fiscal Accountability of the Nation's Energy Resources, which is charged with developing solutions to mineral management problems with focus on royalty accounting and oil thefts.

PERSISTENT MANAGEMENT PROBLEMS PREVENT ACCURATE COMPUTATION AND COLLECTION OF OIL AND GAS ROYALTIES

Since 1959, numerous General Accounting Office and Department of Interior audit reports have pointed out the need for improved management of Geological Survey's royalty collection system. For example, in our April 1979 report, we noted that Geological Survey was not collecting all the oil and gas royalty income due because

--lease account records contained numerous errors and omissions,

--unverified data was used to compute royalties, and

--collection procedures were inadequate.

Although Geological Survey has sought to respond to some of the recommendations contained in our report, management problems persist.

In our 1979 report, we stated that Geological Survey's lease account records contained numerous errors and data omissions and could not be relied on to determine the accuracy of royalty collections. As a result, Geological Survey and the oil and gas industry cannot use these records to determine if royalties were properly computed and paid.

The Geological Survey maintains lease account records for oil and gas leases on Federal and Indian lands. Royalties earned and payments made are recorded in the lease accounts maintained by Geological Survey's computer using data reported by the oil and gas companies. If the recorded amounts due and the royalties paid do not agree with each other, the computer, rather than clearing the account, will show a balance. Account balances normally result when the companies

--make an error in computing the amount of royalties owed or amounts paid,

--make an error in reports submitted and used to compute royalties owed or in paying royalties due,

--fail to pay royalties owed, or

--fail to report the data used to compute and record royalties owed or paid.

However, the Geological Survey has also created erroneous account balances by recording charges or payments in the wrong account and by making other clerical errors.

On July 31, 1978, the Geological Survey maintained 22,735 lease accounts. Of these accounts, only 6,569 did not have a balance. Of the accounts with a balance, 9,497 indicated that the amount paid was greater than the royalties due the Government. Although this condition can result from overpayments to the Government by the oil and gas companies, it occurred more frequently because royalties due the Government were understated when company reports were not received and charges were not properly entered in the accounts. The balance of these 9,497 accounts was $49.8 million. The remaining 6,669 accounts indicated that royalties of $38.8 million were due because the amount collected was less than the amount computed as due.

To determine the accuracy of these accounts, we reviewed 714 randomly selected lease accounts for June, July, and August 1977. We noted the following deficiencies which contributed to the inaccuracy of these basic accounting records.

--In 137 cases, royalty payments totaling $258,000 were recorded in the accounts without corresponding amounts being recorded as due.

--In 245 cases, royalties totaling $471,000 were recorded as due without corresponding royalty payments being recorded.

--In 469 cases, the royalties due did not equal the royalties paid. Royalties paid exceeded the amounts recorded as due by $122,000.

On the basis of recent follow-up work, we determined that lease accounts still are inaccurate. As of September 1980, 19,487 or 73 percent, of Geological Survey's 26,769 lease accounts had a balance. Of these, 9,962 accounts indicated that Geological Survey had been underpaid by $134 million; the remaining 9,525 accounts indicated, for the most part erroneously, that Geological Survey had been overpaid by $153 million.

Our follow-up analysis of 275 of the 714 lease accounts we had previously analyzed, for the 3 months ending June 30, 1980, showed that

--In 115 cases, royalty payments totaling $725,336 were recorded in the accounts without corresponding amounts being recorded as due.

--In 97 cases, royalties totaling $276,569 were recorded as due without corresponding royalty payments being recorded.

--In 174 cases, the royalties due did not equal the royalties paid. Royalties paid exceeded the amounts recorded as due by $119,226.

Because of the incomplete and inaccurate data entered in lease accounts, account statements could not be used to adequately manage royalty collections.

Moreover, Geological Survey relies almost entirely on unverified production and sales data reported by oil and gas companies to compute royalty payments due. It makes little effort to verify the accuracy of the data supplied. In fiscal 1980, Geological Survey audited only 5 percent of its lease accounts although past audits have proven beneficial. For example, as discussed in our 1979 report, Geological Survey's Metairie, Louisiana office completed eight audits during the 9-month period ending September 30, 1978. These audits yielded $7.5 million in additional Federal royalty income.

In addition to auditing, Geological Survey could reduce its reliance on unverified data by matching reported production data against reported sales data. By doing so, it could identify potentially serious data inconsistencies which indicate possible royalty payment shortfalls. Moreover, this approach could be further refined by having Geological Survey personnel, who periodically inspect well sites, verify reported production data. However, better data verification procedures alone will not resolve all of Geological Survey's financial management problems. It also needs to develop a viable royalty accounting system, which will assure that information reported is properly accounted for and that necessary controls are in place to assure the accurate and complete reporting of royalties.

Also, as noted in our prior report, Geological Survey was not receiving timely payments of royalties. In 1977, late payments amounted to $359 million. These payments were not received within the timeframes specified in leases because Geological Survey

--did not adequately enforce lease provisions calling for timely payment of royalties, and

--did not impose appropriate administrative fees or interest charges on those making late payments.

Based on our analysis of 275 lease accounts for the 3 months ending June 30, 1980, we project that late payments totaled $98 million for that quarter alone. Had these delinquent payers been assessed interest charges equal to the cost of Federal borrowing, they would have owed an additional $400,000 for the 3-month period alone. Unfortunately, Geological Survey did not take timely action on this problem, despite our earlier report.

In our prior report, we recommended that procedures be established to charge interest on late payments. Geological Survey, however, has been slow in implementing this recommendation. Interest was not charged on late payments applicable to offshore leases until September 1980. Further, procedures for charging interest on late payments made by onshore lease holders were not effective until March 31, 1981, and to date no interest has been collected for late payments on onshore leases.

GEOLOGICAL SURVEY IS MAKING AN EFFORT TO CORRECT ITS FINANCIAL MANAGEMENT PROBLEMS

In our 1979 report, we cited evidence indicating that the Geological Survey may not have been collecting as much as 7 to 10 percent of the royalties owed the Federal Government. This--the only such estimate we are aware of--is based on the experience of a private oil and gas company which audits oil and gas leases. Currently, Geological Survey by its own admission is not collecting over $1 million per day in royalties.

Geological Survey, recognizing that its accounting system was inadequate, formed a task force in October 1978 to recommend system improvements. In December 1978, the task force recommended that a new royalty accounting system be designed and implemented. That system is not yet operational and will not be fully operational for several years.

Geological Survey completed a feasibility study and cost/benefit analysis for a new system in March 1981. It plans to award a contract for design of the new system in September 1981. The system will be implemented in three phases over a 5-year period. The three phases consist of (1) the royalty accounting phase, (2) the production phase, which will permit the matching of production and sales data, and (3) the enhanced management phase which will center on developing quality review and management data.

Geological Survey currently estimates that the royalty accounting phase will be fully implemented in fiscal 1983, and the production phase by fiscal 1984. If the system is effective, Geological Survey should be able to better account for and control royalty payments. Until then, however, it seems that Geological Survey will be hard-pressed to fully carry out its royalty collection responsibilities.

Geological Survey does not plan to transfer existing account balances into the new royalty accounting system. Thus, besides actively working to develop the new system, Geological Survey also has to develop a plan for reconciling old accounts and identifying and collecting previously uncollected royalties. In

June 1981, Geological Survey announced that it plans to audit the 20 to 25 largest oil and gas companies, which account for over 80 percent of the royalties due. To assure that all royalties are being properly paid, it is imperative that a long term program be developed to provide for periodic auditing of lease accounts.

In closing, we would like to emphasize that the problems discussed above can only be corrected through a sustained high priority effort--one with long term top management involvement.

This concludes my prepared statement. We would be happy to respond to any questions.

Senator WALLOP. Thank you Mr. Simonette. John, do you have questions?

Senator MELCHER. Mr. Simonette, all your detail work was prior to 1979—during 1979 and prior to 1979?

Mr. SIMONETTE. Yes, sir, that's correct. We have done some followup work.

Senator MELCHER. What did that followup work consist of? Just talking to GS or did you actually go do something?

Mr. SIMONETTE. We have done followup work including examining I think some 275 lease accounts.

Senator MELCHER. What do you mean? Sampling them?

Mr. SIMONETTE. We—in our prior review we—we had a sample of some 750 accounts that we examined. For this followup effort, which has been a fairly limited effort because of time constraints, we selected some 275 of that 700 that we had reviewed back in 1978–79 to determine whether to—to get some indications as to whether the problems still exist and what—what the magnitude might be. So we have done some detailed work, and I—my associates can get into some more detail as to just what that consisted of. So we have gone back into and examined some 275 account balances to see what their condition was.

Senator MELCHER. Well, what about your first study? How did you determine that anything could be done to correct this without starting right at the grass roots with proper accounting on how much oil was produced on any given lease?

Mr. SIMONETTE. Well——

Senator MELCHER. Or didn't you think that was part of the ballgame?

Mr. SIMONETTE. We did feel that was part of the ballgame.

Senator MELCHER. Well, what did you come out with? We don't find it in your report, you know. Your report gives a lot of data on how you could account for production better; but I couldn't find in your report where you gave any details on how much was actually produced on the lease.

Mr. SIMONETTE. We tried to address that, Senator, by identifying alternatives that we felt that Geological Survey could explore in terms of identifying how much oil, how much gas was actually being produced.

Senator MELCHER. Did you have any better way of doing it than gaging tanks or LACT meters?

Mr. SIMONETTE. Could I ask Mr. Steinhoff and Mr. Baughman?

Senator MELCHER. Did you get into it? Did you get right down into the basics of this, how much oil is produced from a given well?

Mr. STEINHOFF. In our prior study we mentioned the fact that it was very important that you audit the lease accounts and that the——

Senator MELCHER. That you audit the lease accounts?

Mr. STEINHOFF. And that there be a working relationship between those who inspect the wells and those who account. In other words, you must have both parts working together. When we talked about the accounting system, you've got two parts. You've got the accounting for the data that the oil and gas company reports; and you also have to verify what they report.

And we believe it to be very important that you tie both parts together.

Our 1979 report does address the fact that in order to have a viable system they have to audit the lease accounts. And they must also tie in the lease inspections to the accountings.

Senator MELCHER. Well, I'm talking about something much more basic than that. I'm just not talking about auditing the accounts. I'm talking about counting the number of barrels that come out of a well.

Mr. STEINHOFF. Right.

Senator MELCHER. It was nice to have your report. It's helpful. It really gets into what's wrong with the royalty accounting system, but it does not get into the part that I think is so basic which is to determine what's wrong with GS and their methods of counting the number of barrels that come out of a well. Until you know what comes out of that well and into a storage tank to begin with, you are never going to know whether the amount that is sold off the lease is the same amount that was produced.

Well, not to belabor that, but, Mr. Simonette, where did you get the figure of $1 million? GS talked to us in three different hearings and inquiry yesterday, and they've never admitted to a $1 million-per-day loss. The Secretary of the Interior, the head of GS, and everybody connected with them said it might be up to a million dollars. Are you going to take the $1 million-dollar-per-day loss figure? That's something that occurs every Monday, Tuesday, Wednesday, every day?

Mr. SIMONETTE. This was a—Senator, this was an estimate that was presented by GS in a hearing before the House Government Operations Committee some few months bask.

Senator MELCHER. Well, we'll check with Mr. Frederick. He's here, but they've always testified that it could be up to $1 million because they really didn't know where they were. But I never heard anybody testify to a good fat round figure of $1 million-a-day loss that occurred every day of the week, every day of the month, every day of the year. I don't think they're going to testify to that.

Mr. SIMONETTE. We——

Senator MELCHER. But you didn't get it on your own findings?

Mr. SIMONETTE. We did not. We said in our 1979 report that—and by—I--quite frankly it was very difficult to—we tried to pinpoint or quantify what would be the potential loss or losses. And, of course, that was impossible to identify. We did find in the report and experience of one private company that was involved in auditing leases, and they gave an estimate of some 7 to 10 percent. We cited in the report and in that context—not to say that it was audited or that it was—it could be even more or even less. But that it was some indication, the best that we could go on at that point. So that's the——

Mr. STEINHOFF. I would like to add something to that. There is nothing hard—we aren't trying to say here that exactly $1 million is lost every week, Senators. It gets back to our initial point. If you don't control it when it comes out of the ground, if you don't verify production, you have no way of really—really knowing. I think that's one of the points we tried to make back in 1979.

Senator **Melcher**. I'm not going to be heavy on the criticism because obviously what you did was of much benefit to us in 1979. But I will state that the report is not adequate in stating on where the oil starts, where the whole accounting procedures start; and that is to make sure that somebody knows how much was produced. This involves what I think is the most serious problem. I'm all for getting a real, honest to goodness, dependable modern accounting system and getting rid of this archaic one that was developed in the fifties. But I don't think we're ever going to get to that point. I think Secretary Watt agrees because he appointed a blue ribbon panel. I think they're going to agree we're never going to get to that point unless we know what the Conservation Division of USGS is doing in the oil patch interns if making sure how much oil is produced from any given Indian lease or Federal lease. I know they are under staffed, and I know they do not have people with enough training. And I've heard all this discussed over and over.

But frankly, I don't think GS has got a plan yet for reorganization of the Conservation Division at the grassroots to make sure that somebody there right on the lease itself knows where the oil is coming from, out of which well, how much is coming each day and how much is being stored, checking that out against how much is sold, and then applying the production accounting to the royalties. That comes afterward.

Mr. **Baughman**. The accounting part does have some control because when you start, you have a decent accounting system. If you start having fluctuations in oil, it may show up. If you have one month a thousand barrels, the next—there is a question that can be asked.

Senator **Melcher**. That's obvious.

Mr. **Baughman**. That's what we're dealing with, our approach——

Mr. **Simonette**. I think also, Senator, just to make one more comment—and certainly our report only went so far, and we'll be the first to admit that. But I think we did try to stress in the report that, and we don't have the answers. We don't have the whole solution, but there was no assurance that everything that was owed to the Federal and to the Indians was being received.

Senator **Melcher**. And to the States.

Mr. **Simonette**. And to the States.

Senator **Melcher**. And to the States.

Mr. **Simonette**. In that GS did not have a means to determine what the correct royalty should be.

Senator **Melcher**. That goes without saying, and you made that case. But I'm just stating that your ex-boss, Mr. Staats, and the Watts' panel are going to find that you're going to have to go back and start with the oil as it comes out of the well or, for that matter, natural gas as it comes out of the wellhead, and then determine if it is being checked in, you know, and start with that figure. Having that figure established, you can then go on to get the rest of it accurately.

Thank you very much for your responses, all of you.

Senator **Wallop**: I hope that if you started making recommendations like that, you recommend how you can determine what the production of a given well in gas is or oil is and list all of the other chemicals that come out because production records, in the case of a gas well is not just gas or an oil well is not just oil, especially if you are pumping a lot of oil or are doing enchanced recovery. It's not easy to go down there and put a meter and get it out.

Senator **Melcher**. I think that's why they need these engineers.

Senator **Wallop**. Well, that brings me to question I would like to ask.

You're talking about the design. In December of 1978 the task force recommended a new royalty accounting system be designed and implemented. It not yet operational and will not be for several years. Who is designing that?

Mr. **Simonette**. USGS currently is planning to award a contract, I believe, next month the royalty accounting system.

Senator **Wallop**. Have you given any counsel on that process?

Mr. **Simonette**. We have not given any counsel on that; no, sir.

Senator **Wallop**. I'll ask them because one of the things that is a little distracting to me is this passion for finding means to avoid conflicts of interest at all costs. They're going to get people who don't know a damn thing about what's coming out of the ground or how it's processed. Then you'll get a system that's designed to cost us money to operate, and I understand one of the criteria is that they not have worked for an oil company or——

Mr. **Simonette**. I'd like to correct that, Senator. There are two contracts, and perhaps GS can certainly elaborate on this.

There are two contracts on there way. The contract to design—the first contract which, as we understand, they're about to award in probably September will be to design the royalty accounting system that the agency will use to account for the royalties due and so on.

The contract you are referring to is actually a second contract involving, I presume, accounting firms making audits of some 20 to 25 oil companies which account for over 80 percent of the royalties paid as we understand it.

And I think GS is still involved in the planning for this effort. This will be an audit effort where these firms will actually go to the oil companies and make audits of oil company records in order to determine whether or not all payments were made that were due. So there are two separate contracts.

Senator **Wallop**. There is a look-back audit as well that's completed?

Mr. **Smith**. It is the audit contract that they are now going out for bids that has the clause that you are referring to that eliminates companies from bidding on that contract that has dealt with GS or the oil and gas companies during the past 6 years. It is not the contract for the design of the system.

Senator **Wallop**. Both are important. You must have somebody in the process that understands the business. I would hate to have my accountant design an auditing system. He's just not in tune to that world. He could design a system that would track certain things but wouldn't know the workings of the industry well enough to design an effective audit system. It would seem to me that you must have some basic underlying knowledge of what it was you were looking for and where to go to look for it before you could do an audit worth its salt.

Mr. **Simonette**. That's true.

Mr. **Smith**. Yes.

Senator WALLOP. So, even in the greater accounting process, isn't it a very good idea to have some preexperience in the industry?

Mr. BAUGHMAN. Geological Survey did train our staff on how to look at this stuff when we were doing it. This takes considerable time to do it.

Senator WALLOP. The question is who's training you for what purpose?

Mr. BAUGHMAN. Yes.

Senator WALLOP. What happens in the meantime? What would you recommend to the USGS that they do while this process is going on? Two questions: What happens if the thing goes on and the blue ribbon panel recommends another procedure?

Mr. SIMONETTE. If—well, that's—that's some concern we have too, Senator. We, of course, don't know what direction the panel may take.

We will be working with them, and in fact we will be appearing before them later this month. We do feel that the—in talking to Geological Survey and in looking at the plans that they have so far, the philosophy that they're following, that if this is carried out to the ultimate extent and that system is completed properly, that they would address the major points that we made in our report back in 1979. But as far as whether the—the panel comes up with something entirely different, I think this could cause GS some considerable problems.

Senator WALLOP. But I guess the other side of my question is: What do they do in the meantime? They haven't got a system designed yet, and it's going to take a while to complete it.

What can they or should they be doing? To your knowledge are they or are they not going to streamline and improve the system that brings us here?

Mr. SIMONETTE. Mr. Steinhoff?

Mr. STEINHOFF. At the time of our 1979 report we made both short-term as well as long-term recommendations. Some things that they could have done since that time would be to intensify field inspection efforts to do what Senator Melcher mentioned, get at the production, the right one that's being produced and try to verify. In that way they could go back and reconcile some of the 19,000-odd accounts that are not in balance today.

They can provide more of an auditing effort. They are in the process, we have been told, of hiring 130 auditors, but for the next several months or years they'll be involved mainly in working with the oil companies to get on line with the new system.

I would say until they have a new system on line, however, that the problems that are in place today will probably continue. They probably won't be able to do much unless they do provide much—much greater staffing as far as inspections go.

Senator WALLOP. I appreciate one thing that was in your report and, the categorization of oil and difference between barrels as it comes out of the ground—the price, age, and so forth. Certainly gas has added to the complexity in the problems of the country. The Natural Gas Act may well have cost us more than it sought to provide in terms of stability for other people. Thank you very much for your attendance here.

Next is Mr. Doyle Frederick, Acting Director of the U.S. Geological Survey, Department of the Interior. And he's accompanied by William Feldmiller, USGS royalty accounting, Denver; and Arnold Petty, Deputy Director for Services, Bureau of Land Management; and Mr. Jim Yohe, Assistant Inspector General. Department of the Interior.

Welcome, gentlemen. Thank you for your presence and cooperation. Please proceed.

STATEMENT OF DOYLE G. FREDERICK, ACTING DIRECTOR, U.S. GEOLOGICAL SURVEY, DEPARTMENT OF THE INTERIOR, ACCOMPANIED BY WILLIAM FELDMILLER, ROYALTY ACCOUNTING, DENVER OFFICE; ARNOLD E. PETTY, DEPUTY DIRECTOR FOR SERVICES, BUREAU OF LAND MANAGEMENT; AND JIM YOHE, ASSISTANT INSPECTOR GENERAL, DEPARTMENT OF THE INTERIOR

Mr. FREDERICK. Thank you. Senator Wallop, Senator Melcher, we're pleased to appear before the committee today and address many of the questions that have been raised both by the State of Wyoming and by the General Accounting Office.

We are prepared, Senator Wallop, to summarize the testimony. Testimony copies are available for the committee and members of the audience. So we would be pleased if you would go ahead and take one.

There are two or three things that I'd like to accomplish today in terms of—of this particular problem. I'd like to share with you the Geological Survey and some of the Department of the Interior management concerns about this problem, tell you a little bit about what we're doing, then we're prepared to address in any detail that you choose aspects of our accounting system or other questions that might come up. We do have a—as I say, Arnold Petty from the Bureau of Land Management—you have asked questions about the distribution of funds. Arnold has prepared a testimony that is available too. We can ask him to speak if you choose. Just use your own judgment on that. And I have with me Bill Feldmiller who has been the internal Geological Survey task force members on our royalty management system improvement for the last couple of years, and Jim Yohe from the Inspector General's Office is here to answer questions relating to their investigation and—in the Department of Energy.

Senator WALLOP. Why don't you put on your presentation as you would most like to have it.

Mr. FREDERICK. OK. All right, very well. Very well. Let me—let me just go back and adress some of the questions that the GAO has discussed with you just now, and I'll deviate from my prepared testimony just to make sure I cover the points that they brought up and the questions that you've raised, those that were addressed to the Geological Survey with regard to the magnitude of the problem. I'm talking about the royalty accounting problem, and at the moment we—we would indeed suggest that the—the losses could be as much as a million dollars a day. And, as Senator Melcher indicated, we emphasize could because we're not at all sure exactly what the amount is.

We have conducted audits ourselves. The Interior IG has just finished two rather substantial audits. The indications there, on one fairly sizable account the percentage was on the order of 7 percent. Now, that 7 percent was based on a technical interpretation of the law proper value in essence.

Another account which was investigated thoroughly amounted to somewhere in the order of one-sixteenth of 1 percent, but those were—were two of the rather—rather large firms.

Now, we don't draw any significant conclusions from that other than the fact that indeed there are opportunities for underpayment with the existing system and with the amount of data that—that we now have available to us for following up of the—on the average. So we do recognize that there is a problem and do indeed intend to do something about it.

Now, Senator Melcher has made a point a few minutes ago about knowing how much oil is indeed produced from—from the leases. It's a question that he's discussed with us several times, and—and we indeed will address that issue. We're not sure that we're going to be able to count the number of barrels of oil coming out of the lease, but we are pursuing that question and will do whatever we can to provide that part of the day to day as accurately as possible.

We will, in our new system, provide for the ability to—to account for the production records that the industry submits, and hopefully with the new production accounting system that we are—that we're designing and will implement later on we'll be able at least to compare production reports with what our technical and professional people would expect to come from a well or a field of the size that we will be examining.

So just generally as far as the problem is concerned, we do indeed recognize that there are problems with the system that was developed in 1950, and we have set about to do something about it.

Now, what are we doing about it? Let me just summarize that, and then we'll open ourselves up for questions.

We are preparing a new production audit system. That contract, as the GAO fellows told you just minutes ago, will be let sometime in the fall we hope if there are no problems, and we are on track to—to let a contract for that system.

Now, that—that particular system is a multifaceted system, and will be brought on board in incremental stages. The accounting part should be available by 1983 in its full capacity. The accounting—the production accounting part should be available in 1984 in its full extent.

We are addressing the matter of old accounts now. There is concern about what happened in the past, and I know you neglected that. I believe Senator Melcher mentioned that—that we weren't providing for the lookback at the old accounts in our new system. But we are preparing, as was mentioned again earlier, in cooperation with the Interior Inspector General to look back on old accounts.

Now, we have selected already with the Inspector General's help two accounts that we'll look at thoroughly. On the basis of what we find looking at those accounts we will make a determination as to whether or not we ought to look at a sizable percentage of the existing accounts.

We expect that we probably will decide to do that, and that problem will be an Inspector General decision in terms of whether to go forward and look at those accounts rather than—rather than a Geological Survey decision; although, we will indeed participate in the review.

Now, those accounts will be audited by CPA firms selected by the Inspector General. I believe maybe to answer one of the questions that you had asked of the GAO, in that case I believe the Inspector General is insisting on some rather strict conflict of interest kind of requirements since that the—the CPA firms chosen would not be CPA firms that had worked for industries in at least the past.

Senator **Wallop**. Could I interrupt? Are you prepared to answer how you are going to provide, I mean select the expertise necessary?

Mr. **Yohe**. It's still in the process of selecting the expertise. We haven't seen the input as to who we would select. The final decision hasn't been made, but of the two different independent certified public accounting firms doing two separate oil companies——

Senator **Wallop**. But they—if they haven't worked for either industry or GS, how in the hell are you going to get anybody who knows what they're doing? And how are you going to rely on the proper——

Mr. **Frederick**. Senator Wallop, we are concerned about that.

Senator **Wallop**. You should be. I didn't come here to upbraid anybody, but I think it's important that paranoia about conflict of interest doesn't result in a product that costs us a lot of money.

Mr. **Yohe**. I'll relay your interests to the Attorney General Monday.

Mr. **Frederick**. We do have a task force created within the Geological Survey, and it includes members of the Inspector General's office. That task force consists of our most knowledgeable people in the accounting area. Their job has been to this point to design the pilot test and to work with the contractor to make sure indeed the contractor is looking for the kinds of things—in this case the contractor is the CPA firm—to assure that the contractor looks for the kind of things that an experienced auditor on oil and gas accounts would identify as being promising, those things that would be critical.

So we'll keep that task force in effect. At least that's our plans at the moment, and work with the accounting firm very, very closely to design the approach and make sure indeed the——

Senator **Wallop**. I sure wish you luck. It's not a simple business, and I believe that it's important that you pay attention to the potential for conflict of interest. I mean, I don't—I don't quarrel with them, but I also believe that sometimes it is important to go on the reputation that is given that an organization has for integrity in its field and that there are honest people in America, believe it or not, and people that have professional pride that far outweighs their greed. And I just think—I worry that you get something that doesn't tell you anything that people with no experience can be bamboozled.

Mr. **Frederick**. Yes; I think the Inspector General's Office did a very good job auditing the accounts that they've just reported on. Our people did work with them almost daily on those accounts, and they came in ——

Senator **Wallop**. In your field, though, if you work with people daily then they pull out——

Mr. **Frederick**. But in any event, we think they did a good job. And it required a lot of effort on their part, but I think it was worthwhile. We believe we can work something out.

Senator **Wallop**. Forgive me for interrupting.

Mr. **Frederick**. No problem. Now, that's the action that we're taking to—to deal with the concern about past undercollections. We're not suggesting that that's a complete answer necessarily, but we indeed intend to look thoroughly at the old accounts and to make sure that just because we're not able to include that information into the new system it's—it will indeed not be forgotten.

OK, now, one more thing that—that we're doing specifically at this point, and that's to convert industry as quickly as we possibly can to the reporting format of the new system. And we recognize that it takes time to bring the new system on board, and industry is prepared to go ahead and make the conversion—at least a large part of the industry is prepared to go ahead and make the conversion. And we think it's important to have that information on hand, address it as quickly as we possibly can. So we're designing an internal system which is essential to the system—to the format.

Now, what that does for us, of course, is convert industry quickly, make sure we have a data base of the new information available so that we can process it more thoroughly once the new system comes on board so we will not have lost from that point of view.

OK, two or three other items that I might—I think the question of late payment charges—we are—we have instituted an interest penalty for the late and underpayments both for on the onshore and offshore ideas in effect at the—at the moment. We have met with the State governments to look at the possibility of cooperating with the States.

I believe Mr. Swan mentioned a few minutes ago some possibilities that we have indeed talked to the States already about. Pursuing the idea of exchanging information, of course, is very—a very attractive idea to us. To be able to make our system work, we must indeed have information on production rates and information on sales and independent sales documents and that sort of thing. And we will look to the States to be able to provide because it is in their interest as well as our own that the most accurate information be provided on a timely basis.

So we're pursuing that specifically through the interstate oil compact commission. We're working on a format for exchange of information, and we intend to pursue that question with five or six States. And I don't have the names of those States right at the moment, but I can get that for you later if you wish to look at a format for exchange of information.

In addition to that, Mr. Swan suggested maybe giving some additional responsibilities to the States. We'd be happy to pursue that matter with you—with the States, and we'll indeed follow up with Mr. Swan to talk about that more thoroughly.

Now, several have mentioned the—the commission on fiscal accountability of the Nation's energy resources, and we too are happy to cooperate with Mr. Linowes in that commission. We think it's an excellent idea to have an independent view, especially views of people so qualified as those that are members of that particular commission. We've testified before the commission on one occasion already, and we'll indeed testify before the commission again.

We welcome their input and do intend to heed it.

The Secretary established a commission to—to make sure that the—that the steps that were being taken by the Department of the

Interior were indeed adequate, commensurate for the problems that exist. I believe he feels that the commission is qualified to deal with that, and he's given independent license to look at any aspect of the problem that they so choose. They are scheduled to report back to the secretary in 6 months, which is a little later than some of the specific actions that we planned. And that question came up just a few minutes ago in terms of what we would do if the commission made a recommendation that didn't fit exactly with the path that we've chosen.

We—we know that that indeed is somewhat of a problem. The system that—that we are designing for the contracts that we've let we believe has the basic integrity to withstand the scrutiny of the commission at this point. If indeed there are recommendations that suggest that perhaps we're going in the wrong direction on one aspect or two of that, we believe we have flexibility in the contract to make some changes. It might cost us a little bit, but we think we have flexibility to make those changes.

We indeed feel we must go on because we're fairly confident that our system is a good system, and that indeed it is needed.

So we would like not to wait—to wait on the final recommendations of the commission, but we do believe that we'll be able to accommodate those.

Senator Wallop, that summarizes what I wanted to say on the part of the Survey. We do consider the royalty management problem a high priority problem in the Geological Survey. The Secretary of the Interior considers it to be a high priority problem, and we believe that—that we're taking prudent action at the moment to—to deal with the issue.

Like I say, we have others with us at the table who can answer some specific questions. If—if you'd like Mr. Petty to talk to you about the distribution of funds, he's prepared to do that, and you can ask him to.

Senator Wallop. I think it would be helpful.

Mr. Petty. Mr. Wallop, as you know, talking about—basically about the Mineral Leasing Act of 1920, that prior to the amendment of 1976 provided the States got 37½ percent of the receipts. Fifty-two and a half went in reclamation funds, 10 percent to general fund. In 1976 that was amended to give the States 50 percent except for Alaska. And your colleague there has always been pretty successful in taking care of Alaska, and, of course, he gets 90 percent.

Alaska, when it came into the Union, has got 90 percent from oil receipts. Their BLM collected the rents and royalties and the rents and bonuses and put it into the account.

GS collects the royalties twice a year. We add those up, and we distribute them in the way that is called for. And basically that's the way that that system works. Because we've seen the account grow dramatically here in the last few years, and it's obviously going to grow dramatically here in the future. There is one thing that you need to take note of, both the original act and the present act provide that the payment be made to the States.

The original act said the—encouraged the State legislature to use that money for schools and roads.

The current act, as it was modified by FLPMA has some rather different language in it. The law now provides that the funds are to be used by the States as directed by the legislature given priority—priority, and I quote:

> To those subdivisions of the state socially or economically impacted by development of minerals leased under this act for (i) planning, (ii) construction and maintenance of public utilities, and (iii) provision of public service * * *.

I bring that up because it gets to be a little controversial, in some of our States when the county and the state start dealing together.

Senator WALLOP. You have to audit that too?

Mr. PETTY. No, sir. The law makes no provision for us to audit that thank goodness. That pretty well summarizes my statement.

[The prepared statements of Mr. Frederick and Mr. Petty follow:]

TESTIMONY OF
DOYLE G. FREDERICK
ACTING DIRECTOR
U.S. GEOLOGICAL SURVEY
DEPARTMENT OF THE INTERIOR
BEFORE THE
SENATE ENERGY AND NATURAL RESOURCES COMMITTEE

AUGUST 11, 1981
CASPER, WYOMING

Mr. Chairman:

Thank you for the opportunity to appear before this Committee to testify on the issue of mineral royalty accounting, collection, and distribution. My office is at the USGS headquarters in Reston, Virginia, and I am accompanied by Mr. William Feldmiller from our Denver office whom I would like to introduce and who will assist me with my testimony and in answering any specific questions you may wish to ask.

Let me first give the Committee a little background describing what the USGS does and the scope of those activities.

The responsibility for carrying out the functions under discussion today resides with the Geological Survey's Conservation Division.

The Geological Survey's onshore oil and gas lease management program has three primary functions. The first is the classification and evaluation of mineral resources, the second is the regulation of industry's operations, and the third involves the collection of royalty on producing leases. The classification of Federal lands as to their oil and gas potential is a safeguard against improvident disposal of such rights. An economic evaluation of both Federal and Indian lands offered for competitive leasing is performed to assure that a fair market value is received in consideration for the rights to be granted. Once a lease or contract is issued by the surface management agency, the regulatory phase of our activities begins. The Geological Survey receives applications to conduct operations, consults with the appropriate surface-managing agency on such proposals, prepares related environmental documents, approves or rejects each proposal, and supervises the approved operations. The supervision is accomplished through inspections designed to verify compliance with applicable laws, regulations, and lease terms, as well as with stipulations imposed as a condition of approval. The other major function, royalty management, involves the collection, accounting, and verification of all production, minimum, and compensatory royalties and certain advance rental payments.

The reports of the USGS Task Force on Royalty Management of December 1978 and of the GAO on the same subject of April 1979, both concluded that the current royalty collection and accounting systems were inadequate. Both reports speculated that substantial sums were being lost to the U.S. Treasury and to Indians, but that specific amounts could not be estimated. Since then, much confusion and controversy has centered around determining both the nature and magnitude of the undercollections.

The magnitude of the undercollection was said by the GAO to be "up to 7 to 10 percent," based on surveys of companies who audit partners engaged in joint ventures. The truth is, we don't really know--and that fact alone gives us cause for concern. We neither collect all of the data needed to know nor do we have the computer systems to interpret the data. We are confident that a major systems replacement is a good investment however, in view of the fact that all replacement costs are expected to approximate only one-tenth of one percent of the total royalties expected to be collected during the same 3-year period of systems development and installation.

THE NATURE OF THE UNDERCOLLECTIONS RESULTS FROM NOT ALWAYS HAVING THE NECESSARY INFORMATION WE NEED. WE KNOW OF NO RECENT INSTANCE OF FRAUD INVOLVING THE WILLFUL OR GROSSLY NEGLIGENT FALSIFICATION OF A SALES OR REMITTANCE REPORT BY A ROYALTY PAYOR. WHAT WE BELIEVE IS HAPPENING IS THAT COMPANIES ARE MERELY INTERPRETING THE LAWS AND REGULATIONS TO THEIR BENEFIT. THE U.S. INCOME TAX SYSTEM IS ANALOGOUS TO OUR SITUATION: TAX EVASION IS A CRIME, PUNISHABLE BY IMPRISONMENT; HOWEVER, TAX AVOIDANCE, AS YOU KNOW, IS CONSIDERED A LEGITIMATE BUSINESS PRACTICE. COMPANIES INTERPRET THE RULES IN THEIR FAVOR, IRS INTERPRETS THE RULES IN WHAT THEY BELIEVE TO BE THE PUBLIC INTEREST, AND A PROCESS EXISTS TO RECONCILE THE DIFFERENCES. FOR THIS SYSTEM TO WORK, HOWEVER, EQUIVALENT INFORMATION HAS TO BE MADE AVAILABLE TO BOTH THE INDIVIDUAL OR COMPANY AND THE GOVERNMENT. IN THE CASE OF THE ROYALTY MANAGEMENT PROGRAM, NO SUCH PARITY HAS EXISTED.

MR. CHAIRMAN, WE BELIEVE WE ARE ON THE RIGHT TRACK TO SOLVING THIS PROBLEM AND ARE AFFORDING THE HIGHEST PRIORITY TO THE TASK. WE DON'T WANT TO DWELL ON THE PAST, EXCEPT TO SAY THAT THE ROYALTY SYSTEMS WE PUT INTO PLACE 20 YEARS AGO TO COLLECT ONE-TWENTIETH THE ROYALTIES ON ONE-THIRD THE LEASES FROM ONE-TENTH THE NUMBER OF PAYORS USING PRIMITIVE COMPUTER TECHNOLOGY CAN NO LONGER COPE WITH THE SITUATION. NOT ONLY HAS THE VOLUME OF ACTIVITY INCREASED, BUT SO HAS THE EFFECT, SOMETIMES ADVERSE, OF INCREASING REGULATORY INVOLVEMENT OF OTHER FEDERAL AGENCIES.

WE WOULD NOW LIKE TO ACQUAINT YOU WITH SOME OF THE ACTIONS THAT HAVE BEEN TAKEN, THAT ARE NOW UNDERWAY, OR THAT ARE PLANNED FOR THE NEAR FUTURE, TO ADDRESS THE PROBLEM. WE HAVE ALREADY COMPLETED MUCH OF THE DESIGN WORK FOR THE IMPROVED, COMPUTERIZED ROYALTY COLLECTION SYSTEM. A CONSOLIDATED ROYALTY accounting center has been established at Denver supplanting 11 regional collection centers. Computer hardware is already on order for the center which, when operational, will permit same-day depositing of royalty payments to the Denver Federal Reserve Bank and save the U.S. Treasury up to $20 million in lost interest in the first full year of operation. An interim collection system is nearing completion that will permit an accelerated conversion of all payors to a new reporting and paying format that will facilitate audits. This conversion is slated to begin this October 1, and by next spring, 84 percent of the royalties will be paid based on improved reporting information.

A companion production auditing system is also to be designed to provide a much-needed check of production reports against sales reports. Our schedule calls for the conversion of industry to a new production reporting format to occur by October of 1982. Requests for Proposals (RFPs) have been issued and proposals have been received for all needed system design, installation, and operations support. All contracts needed for all major improvements will be let within the next 30 days.

A "Lookback" audit program has been initiated in cooperation with the Interior Inspector General to ensure the detection and collection of underpayments that occur before the new systems are operational. We are now in the process of looking at selected payors. If it appears from the test that a more intensive effort would be profitable, we would plan to perform other external audits of the largest payors. These audits, while labor intensive, are expected to be cost-beneficial and will be conducted by contract CPA firms who pass rigorous conflict of interest tests.

FINALLY, SECRETARY WATT HAS RECENTLY ESTABLISHED A SPECIAL COMMISSION TO PROVIDE HIM WITH AN INDEPENDENT ASSESSMENT OF THE SITUATION TO ASSURE HIM THAT ALL NEEDED IMPROVEMENTS WILL OCCUR. WE HAVE ALREADY GIVEN A PRESENTATION TO THAT COMMISSION AND WILL CONTINUE TO COOPERATE WITH IT IN IN EVERY WAY POSSIBLE.

I WOULD LIKE TO TAKE THIS OPPORTUNITY TO DESCRIBE BRIEFLY THAT COMMISSION. OFFICIALLY, THE SPECIAL PANEL IS NAMED THE "COMMISSION ON FISCAL ACCOUNTABILITY OF THE NATION'S ENERGY RESOURCES." THE PURPOSE OF THE COMMISSION IS TO DEVELOP SOLUTIONS TO MINERALS MANAGEMENT PROBLEMS, FOCUSING ON ROYALTY ACCOUNTING AND OIL THEFT.

THE COMMISSION IS INDEPENDENT AND WILL REPORT DIRECTLY TO SECRETARY WATT UPON COMPLETION OF ITS WORK WHICH WILL BE WITHIN 6 MONTHS. IT WILL EVALUATE THE ROYALTY ACCOUNTING SYSTEM, RECOMMEND IMPROVEMENTS IN CONTROLS RELATING TO ROYALTY COLLECTION, AND REVIEW ACTIONS TO GUARD AGAINST OIL THEFTS. THE CHAIRMAN IS DAVID F. LINOWES, AN ACCOUNTING AND AUDITING AUTHORITY. OTHER MEMBERS ARE: ELMER STAATS, FORMER COMPTROLLER GENERAL; MICHAEL HALBOUTY, A WELL-KNOWN EARTH SCIENTIST AND ENGINEER; CHARLES MANKIN, DIRECTOR OF THE OKLAHOMA GEOLOGICAL SURVEY AND GEOLOGY PROFESSOR AT THE UNIVERSITY OF OKLAHOMA; AND MARY GARDINER JONES, AN ATTORNEY AND CONSUMER AFFAIRS SPECIALIST WHO IS VICE PRESIDENT FOR CONSUMER AFFAIRS FOR WESTERN UNION.

ATTACHED TO MY PREPARED STATEMENT IS A COPY OF THE CHARTER OF THE COMMISSION.

ALTHOUGH THE INVITATION FOR OUR TESTIMONY DOES NOT ADDRESS THE SUBJECT, I WOULD LIKE TO TAKE A MOMENT TO DISCUSS THE ISSUE OF OIL THEFT ON FEDERAL AND INDIAN LANDS AND THE TASKS WE HAVE UNDERTAKEN TO COPE WITH THIS PROBLEM.

Allegations have been made during the past several months that crude oil produced from wells on Federal and Indian lands has been mishandled or stolen over the last several years and that, as a result, the Indian Tribes, individual Indian allottees, the Federal Government, and the States have been defrauded of significant royalty revenues. We recognize that the potential for crude oil theft or mishandling to circumvent State or Federal controls or evade royalty obligations has long existed, exists now, and probably always will exist to some varying degree. Moreover, the present value of crude oil provides perhaps the most favorable environment that has ever existed for the mishandling or theft of crude oil for monetary gain.

We have initiated efforts which we hope will provide us with additional capacity to deal effectively with this problem. First, in September of 1980, we began an intensive inspection program which has concentrated our inspection efforts on the producing oil leases to identify and eliminate those circumstances that might aid those intent on theft or mishandling.

As a corollary to this intensified inspection program, the Survey has developed a "Lease Inspection Procedures" training program for inspectors and supervisors. This training presentation will last 5 days, 3 of which will involve classroom instruction, with the final 2 days covering on-site demonstrations. These on-site orientations will emphasize procedures used in oil field regulatory inspections with particular emphasis on oil diversion and/or theft. This training will be provided to technicians at all grade levels. We will encourage all other personnel involved in oil lease

INSPECTION ACTIVITIES TO ATTEND. ADDITIONALLY, THE TRAINING PROGRAM HAS BEEN OFFERED TO EMPLOYEES OF THE BUREAU OF INDIAN AFFAIRS AT NO TUITION COST AND PARTICIPATION FROM THAT AGENCY IS EXPECTED. THREE TRAINING COURSES HAVE BEEN COMPLETED FOR 130 PEOPLE, OF WHICH 83 WERE CONSERVATION DIVISION EMPLOYEES AND 47 WERE BUREAU OF INDIAN AFFAIRS EMPLOYEES.

ADDITIONALLY, THE FEDERAL BUREAU OF INVESTIGATION AND THE OFFICE OF INSPECTOR GENERAL, DEPARTMENT OF THE INTERIOR, HAVE FOR SOME TIME BEEN INVESTIGATING THE ALLEGATIONS OF CRUDE OIL THEFT AND MISHANDLING. THESE INVESTIGATIONS HAVE RESULTED IN FOUR CONVICTIONS TO DATE.

THE PRIMARY PURPOSES OF OUR INSPECTION EFFORT ARE TO (1) INCREASE THE PRESENCE OF OUR INSPECTION PERSONNEL ON OIL PRODUCING LEASES, (2) IDENTIFY AND REQUIRE THE PROMPT CORRECTION OF ALL CIRCUMSTANCES WHICH MIGHT AID THOSE INTENT ON MISHANDLING OR THEFT OF CRUDE OIL, AND (3) DOCUMENT AND REFER TO THE INSPECTOR GENERAL FOR FURTHER INVESTIGATION ALL CASES WHERE THE ACTIVITIES OBSERVED CREATE THE SUSPICION OF ILLEGAL ACTIVITIES.

FROM OCTOBER 1, 1980, TO JUNE 30, 1981, WE INSPECTED 39,036 WELLS AND 37,927 SEPARATION, TREATING, AND MARKETING FACILITIES ON 13,541 FEDERAL AND INDIAN LEASES.

THESE INSPECTIONS HAVE RESULTED IN THE ISSUANCE OF 4,558 CITATIONS FOR INCIDENCES OF NONCOMPLIANCE (INC'S). OF THE INC'S ISSUED, 90 PERCENT INVOLVED CIRCUMSTANCES WHICH COULD AID SOMEONE INTENT ON THE THEFT OR MISHANDLING OF CRUDE OIL. DURING THIS SAME PERIOD, GEOLOGICAL SURVEY PERSONNEL HAVE ISSUED 135 SHUT-IN ORDERS.

No direct evidence of oil theft has been encountered by our field inspectors during this time. However, operators of jurisdictional leases across the Nation have advised us of 18 incidents of theft during this period, all of which were on Federal lands and all of which were reported to the Department and the Interior's Office of Inspector General. We are also auditing the monthly reports of operations and the monthly reports of sales and royalties for a number of leases and have identified, to date, serious discrepancies in two instances involving five leases. Our findings in both cases have been referred to the Inspector General.

Based on indictments that have so far been handed down by the Federal Grand Jury in Cheyenne, it is clear that some oil thefts have occurred from both Federal and Indian lands.

We have also intensified efforts to recruit an adequate number of inspectors for our onshore programs. We intend to pursue all means available to us to acquire these personnel in order to improve our ability to effectively monitor onshore oil and gas operations by industry on Federal and Indian lands. We realize, of course, that people alone will not solve the problem. Thus, we are looking for and identifying strategies which could be used to improve the effectiveness of our available field personnel.

This includes (1) increased use of air transportation to remote sites so that more time is available for actual inspections, (2) concentrating inspections in areas where acts of noncompliance carry the greater risk, and (3) intensive internal training so that these personnel will have a better understanding of the equipment and facilities involved. This training

WILL ALSO INCLUDE SECTIONS ON THE STATUTORY, REGULATORY, AND LEASE TERM REQUIREMENTS IN RELATION TO THEIR RESPONSIBILITIES, THE SPECIFIC ITEMS WHICH SHOULD BE EXAMINED CLOSELY DURING AN INSPECTION, AND THE REQUIRED ENFORCEMENT ACTION TO BE TAKEN WITH RESPECT TO A PARTICULAR VIOLATION.

ADDITIONALLY, A QUALITY ASSURANCE (QA) TEAM IS BEING FORMED TO ASSESS THE EFFECTIVENESS OF (1) WHETHER TECHNICIANS HAVE CORRECTLY INTERPRETED THE TRAINING INSTRUCTIONS PROVIDED TO THEM, AND (2) WHETHER INC'S ARE BEING PROPERLY ISSUED AND ENFORCED. ADDITIONALLY, THE QA TEAM WILL PROVIDE RECOMMENDATIONS TO IMPROVE THE INSPECTION PROGRAM.

WE ARE WORKING WITH THE INTERSTATE OIL COMPACT COMMISSION TO DEVELOP AN UNDERSTANDING UPON WHICH WE CAN BASE COOPERATIVE EFFORTS WITH THE STATES TO SOLVE THE ROYALTY MANAGEMENT AND OIL THEFT PROBLEMS. AS A MATTER OF FACT, WE HAVE ALREADY HAD CONVERSATIONS WITH SEVERAL STATES AS PART OF THIS EFFORT.

THE GEOLOGICAL SURVEY WILL ALSO MEET WITH INDUSTRY REPRESENTATIVES EVERY 6 MONTHS ON A REGIONAL BASIS TO DISCUSS PROBLEMS OF MUTUAL CONCERN AND INITIATE COOPERATIVE PROCEDURES AS NECESSARY.

BECAUSE WE HAVE NO POLICE POWERS (NOR DO WE SEEK THEM) AND NO AUTHORITY OVER PIPELINES, TRUCK TRANSPORTERS, REFINERIES, OR SUMP OIL RECLAIMERS, THE OVERALL SOLUTION TO THIS PROBLEM INCLUDES BETTER COOPERATION WITH THE BUREAU OF INDIAN AFFIARS, INDIVIDUAL INDIAN TRIBES, AND STATE GOVERNMENTS. SECRETARY WATT RECENTLY MET WITH THE WESTERN GOVERNORS AND PLANS TO MEET WITH

TRIBAL LEADERS IN THE NEAR FUTURE AS A PART OF HIS "GOOD NEIGHBOR" POLICY. ONE ASPECT OF THESE DISCUSSIONS TO WHICH THE SECRETARY HAS ACCORDED A HIGH PRIORITY IS THE DEVELOPMENT OF COOPERATIVE PROGRAMS BETWEEN THE STATES, THE TRIBES, AND THE FEDERAL GOVERNMENT TO LIMIT THE POTENTIAL FOR THEFT OF OIL.

MR. CHAIRMAN, WE BELIEVE WE ARE ON THE RIGHT TRACK IN SOLVING THE PROBLEMS WE HAVE HAD IN THE PAST IN ROYALTY MANAGEMENT AND OIL THEFT. WE HAVE HIRED THE MANAGERIAL AND TECHNICAL EXPERTISE NEEDED, ARE PURCHASING ALL NEEDED COMPUTER RESOURCES, AND HAVE RECEIVED TOP PRIORITY ADMINISTRATION SUPPORT IN SECURING THE RESOURCES NEEDED TO DO THE JOB.

Charter
Commission on
Fiscal Accountability of the Nation's Energy Resources

1. The official designation of the Commission is the Commission on Fiscal Accountability of the Nation's Energy Resources.

2. The purpose of the Commission is to advise the Secretary of the Interior concerning the accountability for revenues generated from minerals activity on Federal and Indian lands. To complete its mission, it will:

   a. examine the allegations of waste and loss of minerals royalty revenues due the Federal government, states, and Indian tribes;

   b. evaluate and recommend improvements to the Department's royalty management system.

   c. recommend improvements in the internal controls in areas related to revenues generated from Federal and Indian lands.

3. The Commission will be in existence not to exceed 6 months from appointment of the last Commissioner.

4. The Commission will deliver its final report to the Secretary of the Interior, and will function independent of, but in cooperation with, established organizations of the Department.

5. Staff support for the Commission is to be provided by the Office of the Secretary.

6. The duties of the Commission are advisory in nature in accordance with this document.

7. The estimated operating cost of the Commission is $187,943, including approximately 1.5 staff-years of support.

8. The Commission will meet approximately 12 times at the call of the Chairman. All meetings of the Commission and all agenda must have prior approval of the Federal Representative. The Federal Representative will be a member of the Interior Department's Office of Financial Management.

9. The Commission shall submit a final report to the Secretary of the Interior within six months after appointment of the last Commissioner, or no later than March 15, 1982, whichever comes earlier, and shall terminate on that date unless extended by the Secretary of the Interior.

10. The Commission is composed of 5 members, who shall be appointed by the Secretary, one of whom shall be designated as Chairman.

11. Creation of this Commission is by the authority of the Secretary of the Interior under 43 U.S.C. 1457, the Mineral Leasing Act of 1920 (30 U.S.C. 191 and 30 U.S.C. 226) and the Outer Continental Shelf Lands Act, as amended (43 U.S.C. 1337, 1338). It is in the public interest in conjunction with the responsibilities of the Department of the Interior to manage royalty receipts from energy resources.

12. Members of the Commission may receive compensation, travel and per diem expenses for each day such member is engaged in the work of the Commission. Travel and per diem reimbursement shall be up to a daily rate in accordance with the Federal Travel Regulations.

13. In carrying out its responsibilities, the Commission is authorized to:

    a. use the support services within the Department of the Interior as appropriate in carrying out its functions.

    b. select an Executive Director and other required personnel in accordance with an established budget.

    c. conduct hearings (swearing in witnesses as appropriate), interviews, and reviews at regional centers and field offices, or wherever deemed necessary to fulfill its duties,

    d. confer with contractors, lessees, Indian tribes and individuals, and other parties dealing with the Department on matters pretaining to the Commission's mission.

14. The Chairman or a Commissioner specifically designated by the Chairman shall be the spokesperson for the Commission for contact with the Congress, public, media, and others.

15. All Commission meetings and activities will operate in accordance with the Federal Advisory Committee Act (5 U.S.C. Appendix I, §10).

James G Watt
Secretary of the Interior

7/8/81
Date Signed

Date Filed

AUG 11 1981

STATEMENT OF ARNOLD E. PETTY, DEPUTY DIRECTOR FOR SERVICES, BUREAU OF LAND MANAGEMENT, BEFORE THE COMMITTEE ON ENERGY AND NATURAL RESOURCES, UNITED STATES SENATE, ON THE COLLECTION, ACCOUNTING AND DISTRIBUTION OF MINERAL ROYALTIES.

I am pleased to appear today before this Committee to discuss the collection, accounting and distribution of mineral royalties.

Section 35 of the Act of February 25, 1920, commonly referred to as the Mineral Leasing Act, provided for the disposition of all revenues from sales, bonuses, royalties and rentals of public lands under the provisions of the Act. Rents and bonuses are collected by about seventy-five offices of BLM and deposited either in a Federal Reserve Bank or a local commercial bank designated by the U.S. Treasury to receive Federal funds. All royalties are collected by the Geological Survey's eleven field offices and are similarly deposited. Both BLM and the Geological Survey record the State and County from which the royalties originate and send the data to BLM's accounting office located in Denver. The accounting office maintains the record of the deposit. Periodically, but at least once each month, the Treasury Department withdraws the funds from the local depositary. At the end of each month the amount recorded by the Treasury Department as cash in the account is reconciled with the accounting records of BLM.

At six month intervals, i.e. during the first week in November and May, the BLM distributes all the funds collected during the previous six month periods ending September 30 and March 31. The BLM notifies the Treasury Department to send checks to each of the State Treasuries equal to 50 percent of the funds collected in the State. Normally the checks are prepared and mailed by the

Treasury Department within 24 hours of BLM's request although the Treasury Department may take up to 72 hours (3 days). All Government checks receive priority attention by the Postal Service,resulting in the delivery of the checks within one to three days after they are mailed.

At the same time BLM makes the request for the checks, the BLM mails to the State Treasury a listing which shows the individual counties from which the funds were collected and the amount applicable to each. The Governor's office is sent a copy of the information supplied to the State Treasury.

The distribution of mineral leasing receipts has gone through two major phases. Before the Mineral Leasing Act was amended in 1976, ten percent of the receipts were paid into the U.S. Treasury and credited to "miscellaneous receipts;" and, except for Alaska, 52.5 percent went to the Reclamation Fund; and 37.5 percent to the State governments. Alaska received the entire 90 percent.

The 37.5 percent allocated to the States was to be used "for the construction and maintenance of public roads or for the support of public schools or other public educational institutions, as the legislature of the State may direct."

The additional 52.5 percent to Alaska was "for distribution by the legislature."

Section 317(a) of the Federal Land Policy and Management Act of 1976 amended the Mineral Leasing Act to change the distribution for all States except Alaska. Ten percent of the receipts is still paid into the U.S. Treasury and credited to "miscellaneous receipts" but now 40 percent rather than 52.5 percent goes to the Reclamation Fund, and State governments receive 50 percent as compared to the 37.5 percent they previously received. Alaska continues to receive 90 percent of the revenues.

As required by the Mineral Leasing Act, payments are made to the States as soon as practicable after March 31 and September 30 of each year.

As I stated, under the original 1920 Act, the money allocated to the States was limited to use for construction and maintenance of public roads, or for support of public schools or other public educational institutions as the State legislature may direct. Now, however, the law provides that funds are to be used by the State as directed by the legislature giving priority "to those subdivisions of the State socially or economically impacted by development of minerals leased under this Act, for (i) planning, (ii) construction and maintenance of public facilities, and (iii) provision of public service; . . . ." The law does not provide for any Federal monitoring of how the States distribute the money.

BLM continually monitors all collections to assure they are deposited promptly to the proper accounts. Failure to pay rentals on the due date results in the cancellation of the lease. Once cancelled, it can only be reinstated by an Act of Congress.

I will be happy to answer any questions.

Senator **Wallop**. Thank you.

Mr. **Frederick**. Senator Wallop, we're available to answer any questions that you or Senator Melcher might have.

Senator **Melcher**. It's nice to see you again, Mr. Frederick. In your testimony you are talking about the most favorable environment that ever existed for the mishandling or theft of crude oil for monetary gains.

Now, you've described thereafter that you've initiated efforts to provide additional capacity to deal effectively with this problem. And part of that was the so-called crash program.

Mr. **Frederick**. Yes. sir.

Senator **Melcher**. That crash program was to give priority to Indian leases as I understand. I think you testified to that in April in Washington at our hearing.

Mr. **Frederick**. Yes, sir. We began with the—with the Indian leases and gave priority to the Indian leases. However, since that time we've expanded to other Federal leases.

Senator **Melcher**. I'm glad of that.

Mr. **Frederick**. As indicated in my testimony.

Senator **Melcher**. I'm glad of that. After you gave that testimony and after that reassurance that the crash program was there and looked at these Indian leases. We just happened to drop in on a lease up in the Blackfeet in Montana and found that on a very well-run ortfit you could withdraw the seals and open up the valves and close the valves and put the seals back on. They are just hanging there Some of the most obvious subterfuge I think any greenhorn would recognize.

Now, that happened to have been inspected under that crash program, and it just disillusioned me completely. I'll have to say that having listened to what the crash program was as far as inspection of these Indian leases and then to find a very well-managed property by the oil company, that's all—that's all the inspector knew about inspecting the lease. He didn't even recognize that opening the valve without breaking the seal wasn't really what the GS regulations was about.

I was shocked, however, Mr. Frederick, when we were in Albuquerque and we got to wondering about where the schematic drawings are, where are the flow diagrams? I just assumed that, while I never found a GS inspector up until that point that knew anything about it on any particular lease, that at least GS required filing those schematic drawings or flow diagrams in the field. I just am amazed to find out you don't.

When you look at a well that's on an Indian lease or a Federal lease and it has a pipe running off a quarter of a mile, half a mile, a mile to a storage tank, how would you possibly know that oil ended up in that storage tank unless you had a flow diagram chart, unless you checked too?

Mr. **Frederick**. Senator Melcher, I'm not sure that I could tell you with absolute certainty we indeed could. As a matter of fact, I guess I could go on further to say that even if we had had a flow diagram, that might not be possible to—to check that put too. Now——

Senator **Melcher**. Well, it would be possible, would it not?

Mr. **Frederick**. Well, I suppose one could go and dig under the pipe and see.

Senator **Melcher**. What about shutting off everything else that went in the storage tank and see whether that line actually went to the storage tank?

Mr. **Frederick**. I suppose that might be possible.

Senator **Melcher**. But when GS gave permission for the right-of-way of that very pipeline, even though it's a small one, what happened to the requirement that a flow diagram be filed with GS?

Mr. **Frederick**. I'm not sure I can answer that, Senator Melcher. We—we may have some folks in the audience specifically who indeed can—can answer that.

Senator **Melcher**. All right. Does one of you want to answer? The field people? Mr. Simms?

Mr. **Simms**. I don't know that we've ever required specifically a—a schematic or flow diagram. What we normally get for the installation of a lease line versus a pipeline is a description of where the line is going to go and the size of the line. That is—that is common practice with the survey.

Senator **Melcher**. What kind of procedure do you require on the right-of-way permit?

Mr. **Simms**. Well, now the right-of-way is handled by the Bureau of Land Management or the Forest Service.

Senator **Wallop**. Could you identify yourself for the court reporter.

Mr. **Simms**. Yes. My name is Jim Simms. I'm the acting chief of field operations here in Casper.

Senator **Wallop**. Thank you.

Senator **Melcher**. Did you check with BLM to see whether they gave them a right-of-way permit?

Mr. **Simms**. If it is a line that is off of the lease in the past, BLM would have to give a right-of-way if it were a lease production on a lease. Until here recently there would not have been a right-of-way.

Senator **Melcher**. I'm asking specifically, Jim, when BLM gives them that right-of-way permit whether you check on what it's for.

Mr. **Simms**. We—we receive an application for the—for the installation of the line and lease, yes, sir.

Senator **Melcher**. So at that point you are told what it's for?

Mr **Simms**. Yes; we are.

Senator **Melcher**. To lead from this well to that storage tank; that simple?

Mr. **Simms**. That's correct.

Senator **Melcher**. Now, you don't keep that on file? You don't have any schematic diagrams to tell your inspectors at the storage battery where the valves are, what the valves mean, what the lines mean, all that spiderwork stuff?

Mr. **Frederick**. Senator Melcher, it's true that we don't have those diagrams. We do understand the problem with regard to our inspectors and the need to—to train our inspectors to recognize what to look for. And that's one of the actions that we've taken specifically is to—to accelerate the training of our inspectors to be able to spot—to spot things like you just mentioned earlier on the—on the reservation, that and the lease well that——

Senator **Melcher**. Federal leases?

Mr. **Frederick.** Yes, sir. And we've already gone through the series of three training programs that—that include a number of our own people plus a member of Bureau of Indian Affairs people specifically to make sur that they understand what to look for.

Senator **Melcher.** Well, in all fairness, I think probably the Indian tribes will make sure that their tribally owned oil and gas is looked at rather carefully. But I think that whatever the pattern is for GS, that that applies to Indian oil. Maybe the BIA and the Indians themselves can get the supervision that they care to.

But what are we doing about Federal leases? What have you got at Denver so far in this royalty accounting system? You got some equipment there?

Mr. **Frederick.** Yes. Let me ask Bill Feldmiller to explain to you specifically what we have in Denver, and what's yet to come. We are indeed centralizing our royalty collections system in Denver. Heretofore they've been in 11 different locations. The royalties were paid to 11 different locations.

We are in the process of centralizing that activity, and are building the staff in Denver, to—to make sure that they're able to collect—to collect the royalties centrally there. And we do indeed have equipment and staff, and we've gone through a rather extensive program to hire staff. And we have been fairly succussful with that.

Bill, why don't you and——

Mr. **Feldmiller.** At the present time, sir, there are 42 people on what we call an improved royalty management program work group. We're in the process of hiring a permanent staff which will approximate 200 in Denver.

We are in the process of acquiring a stand-alone computer capacity that will be delivered in January in time for us to put the—the big part of our lease accounts on a stand-alone computer capacity.

Senator **Melcher.** Isn't it a fact too, Mr. Frederick, that there is nothing really cleared by the Secretary at this point to go forward until we have the advice of the panel?

Mr. **Frederick.** No, sir, that isn't quite the case. The Secretary has indeed appointed the Commission, but he's given us the go ahead on——

Senator **Melcher.** To spend some money?

Mr. **Frederick.** Yes, sir.

Senator **Melcher.** How much?

Mr. **Frederick.** On all aspects of the improved royalty accounting system except the accounting system design contract which—which is just one part of that. Now, we fully expect that indeed, when we are ready to go with that contract, he will give us the OK on that particular one.

Senator **Melcher.** Well, he told me a couple weeks ago or several weeks ago that he was alarmed about spending $200 plus million with the kind of information he had so far.

Has he expressed that to you yet?

Mr. **Frederick.** Well, yes, he's expressed concern about expenditures of that magnitude. Let me comment on that.

Senator **Melcher.** Isn't that what it's going to cost?

Mr. **Frederick**: Ultimately the development of the system and the operation over a 10 year period will cost that much.

Senator **Melcher**. What would a contract cost?

Mr. **Frederick**. Well, we're not sure because right now we're evaluating the bids. And we really don't have the cost information available to us.

The estimate has been somewhere on the order of $20 million to—to develop this system that I've talked about both the audit system and the production accounting system, to produce a data base that has the information on who the payers ought to be, who indeed are they, and—versus who ought—ought to pay plus other information that needs to go into the system to let us make the kinds of checks that we feel we need to make to—to identify the areas of—of most concern to us.

Senator **Melcher**. Well, that's one contract for $20 million. What's the next one?

Mr. **Frederick**. No, sir, that's a series of contracts.

Senator **Melcher**. That's a series of contracts?

Mr. **Frederick**. That amount to about that much.

Senator **Melcher**. And when you say that over a period of years, it adds up to over $200 million?

Mr. **Frederick**. Yes, sir, that includes operation of the system, operation, collection of royalties, and that sort of thing.

Senator **Melcher**. So once you start down this path with this first $20 million, you are starting down a path for over $200 million?

Mr. **Frederick**. Yes, sir, that's right. But we're spending on an order of $15 million now to collect $4 billion worth of royalties. And by 1990 maybe $20 billion.

Senator **Melcher**. I don't know how much it's going to cost. I'm not arguing that point. I'm just trying to get this into focus and——

Mr. **Frederick**. Yes, sir.

Senator **Melcher**. You don't really think it's been put on hold. You just think it's been put on slow down until we find out what this blue ribbon panel really wants?

Mr. **Frederick**. Well, sir, we're not planning to slow down, at the moment, Senator Melcher.

In—there may be some—some things that we have to change as a result of the committee recommendations. And if indeed they find fault with what we're doing, we will take that into consideration.

For the moment we aren't planning to slow down. We think there is enough time built into the system so that we can accept their recommendations and deal with them successfully without slowing down implementation.

Senator **Melcher**. At one time we were told that you were going to start doing something in September. September is almost here. It sounds like a slowdown to me from what you told us last spring.

Mr. **Frederick**. Well, sir, we plan to let the contract in September of this year. That's the design.

Senator **Melcher**. Yor are still going to do that?

Mr. **Frederick**. Yes, sir. Yes, sir, unless—unless the—unless we decide by that time or the Secretary decides that's not an important thing for us to do. We believe that we can do it and still successfully take on board any recommendations that the commission will give us.

Senator **Melcher**. It would be a contract flexible enough to make the changes?

Mr. FREDERICK. We think we can handle that, Senator Melcher.

Senator MELCHER. OK. I'll let you and the Secretary handle that one.

Mr. FREDERICK. Yes, sir.

Senator MELCHER. It seems to me that we're still wondering whether you have corrected your accounting system to quit allowing companies to deduct windfall profit tax from royalties from tribes.

Have you checked that out, or do we have to run into that one about every other month?

Mr. FREDERICK. Well, that one is one that is being dealt with on a continuing basis. Now, I'm not promising you in the old system that something won't occur from time to time. But we are paying attention to those old accounts, and we would indeed reconcile those.

Senator MELCHER. What are you doing about it? I mean, that's a company responsibility.

Have you notified the companies to tell their lawyers and their accountants that windfall profit tax is not supposed to be paid on tribally produced oil?

Mr. FELDMILLER. I believe that's taken place, yes, sir.

Senator MELCHER. Is taking place?

Mr. FELDMILLER. Yes, sir.

Senator MELCHER. How tough is that to do? Has it been done? I'm asking that.

Mr. FREDERICK. Senator Melcher, I don't know whether that's specifically been done or not. But I can assure you I'll find out.

It is something that—that I'm pretty sure we've done, but I'll confirm that.

Mr. PETTY. I do know the companies are well aware of it because they've been making up some of these payments and the Indians began to get some of their moneys. I don't know about notification through the press, but they should know about it now.

Senator MELCHER. Thank you very much.

Senator WALLOP. How are you doing on your time schedule both with regards to the look back and the internal systems as well as your permanent system design?

Mr. FREDERICK. I believe we're on schedule, Senator Wallop.

Senator WALLOP. Do you have adequate resources and manpower?

Mr. FREDERICK. That's—we think we probably have adequate resources for the—for the moment, Senator Wallop. Of course, the folks that are there charged with doing that job might disagree a bit with me in terms of whether or not they have all the people that they need.

We had the division—the conservation division with their permission has given top priority to hiring for the royalty accounting system. They've also given the royalty accounting people permission to go over ceiling at the end of the year with the promise that we'll make it up elsewhere in the Bureau.

Senator WALLOP. They gave you some flexibility with resource?

Mr. FREDERICK. With resource.

Senator WALLOP. And you are prepared to commit those resources to this job?

Mr. FREDERICK. Yes, sir, yes.

Senator WALLOP. That's good.

Mr. FREDERICK. Now, that gives us some problems in the rest of the Bureau, but we're prepared to at least deal with that in the present end-of-year-account date.

Senator WALLOP. Can you or any of the others describe the relationships that exist between inadequate accounting systems and the thefts? Are they related because of their inadequacies, or is there——

Mr. FREDERICK. Well, I think there is some relationship there. Senator Melcher mentioned earlier that it's difficult to account properly if one doesn't know what was actually produced. And I guess I agree with that. So there is a connection there.

On the other side of that particular issue, we think that the—a proper accounting system plus a production—an audit capability on—on production will enable us to—to cite instances where maybe there could be a problem. And we do intend to have—have auditing ready to go out.

We also intend to—to have our inspectors knowledgeable about what the audit system will do so they'll be—they will look for the kinds of things that might help in that regard. There are two distinct problems: one of the oil theft questions and the other is your accounting.

Senator WALLOP. I realize that. Although, the oil theft is easier because of the inadequacy of the accounting system; is it not?

Mr. FREDERICK. I think it may be. We do intend to—as I say—put ultimately into that production accounting system our best knowledge of what ought to have been produced from that well. And if we don't see that reported both in terms of sales or the production information, then that will give us a cause to check.

Senator WALLOP. Mr. Petty?

Mr. PETTY. As a CPA and one who has audited both big oil companies as well as GS, I want to make a point here about the accounting and production Senator Melcher was getting at a few minutes ago.

At least from my days—and I go—it was over 20 years ago when I was in the oilfieds—but the measurement didn't occur at the wellhead. And that's the reason they didn't care about where the line went. It occurred—the line went to the tank battery and was measured when it left from the tank battery into the distribution line.

So your theft could occur right at that tank battery, and you'd never know it. But in those days it wasn't worth very much. So we weren't talking about too much.

Senator MELCHER. Twenty years ago did they call that top hatch—it's never locked, never sealed—the thief hatch?

Mr. FREDERICK. That's an unfortunate title for that.

Mr. PETTY. It was also——

Senator MELCHER. Did they call it the thief hatch?

Mr. FREDERICK. We think so.

Senator MELCHER. It's always been a thief's hatch. Never locked, never sealed.

Mr. PETTY. They used the oil to oil down the road. They used a lot of it right there in the field. They didn't pay royalty on it because it wasn't measured. The last unit wasn't actually put up until it left the tank battery. So I think that's why we don't have a lot of your schematics.

Senator **Melcher**. The flow diagram of the buried pipeline doesn't mean anything crooked, but if it doesn't go to that tank, it goes somewhere else.

Mr. **Petty**. Give you some experience we've had out there in the Gulf of Mexico, we issued the right-of-way. Then we wanted to go find out where it was. We're down 200, 300 feet of water, and it's not as easy to find. We found the thing as much as 3 miles off because what you have to do is plug something in there and measure it electronically. But they sure got off, and there wasn't any idea of theft of croookedness. Just went out, and they wanted their line to go somewhere other than where they originally planned. That could very easily be happening out in the field too because as an accountant, there is so much accounting can do and so much you can't do. And it can't prevent theft in a case like this.

Senator **Wallop**. Well, now, of course, we're not directing this hearing toward the thefts. We're directed toward the accounting procedures. But I would think that the implication is that industry has been generally pretty cooperative.

Mr. **Frederick**. Yes, sir.

Senator **Wallop**. Trying to design this new——

Mr. **Frederick**. Yes, indeed. We have—we've had industry input into the design of the system itself as well as State input. And industry has been very cooperative because they would need to be to make that system work.

Just let me make a point on the whole question of the royalty collection and industry. Turns out that about 25 payers pay 85 percent of the royalties or very close to that. I don't make that for any other point other than that. I don't suggest so, therefore, you don't have anything to worry about because that is indeed true. But it is of concern to industry, and the bulk of the revenues come from 25 of the—of the larger firms. So we do stand a chance of working very closely with the industry and with their interests involved as well as ours to—to hopefully get something done about this.

Senator **Wallop**. Does your Agency calculate the windfall profits obligation of the States?

Mr. **Frederick**. Our agency——

Senator **Wallop**. I find some sympathy with industry as they try to——

Mr. **Frederick**. Yes; we absolutely do find sympathy. We are categorized as a payer of windfall profits for the Federal royalties.

Senator **Wallop**. The States would categorize you as a deductor.

Mr. **Frederick**. Yes, sir. So—so we pay just the same as industry does on the—on the——

Senator **Wallop**. But the point that Mr. Swan was making is that they feel like some of this is coming out of their hides; that as these categorizations of oil and various taxes get assessed, they have no way of finding out the basis upon which their taxes have been assessed. They only get their check.

Mr. **Frederick**. Senator Wallop, it is true that the States would get additional revenue if windfall profits on the Federal royalties were not—were not required.

Senator **Wallop**. They know that. I mean, you know——

Mr. **Frederick**. In terms of——

Senator **Wallop**. Anybody knows that. But the other question is: How do they rely on your figures as the collector of their tax, if they can't have the means of going to your shop to verify what it is——

Mr. **Frederick**. They indeed can—can come to our shop to verify. One of the problems that we've had up until this time——

Senator **Wallop**. I believe it was Mr. Swan's testimony that they cannot.

Mr. **Frederick**. Well, they have not been able to to date, and I just want to comment that we've had trouble——

Senator **Wallop**. New star rising.

Mr. **Frederick** [continuing]. That we've had trouble calculating the exact amounts of the windfall profits because of the requirement to go back on a well-by-well basis and look at the—the various tiers. And we're just now in the process of working with the Internal Revenue to turn over the revenues from the windfall profits. So in doing that we'll also have the information available to the States in terms of what was required.

Mr. **Petty**. If I may, I'll put on the record so that everyone will know exactly how much was withheld from Wyoming during the last payment. Wyoming got a check of $59 million oh—six oh four seven six five and 37 cents, which had deducted from it $3,826,000 even. That was estimated—that was a 5-percent rough estimate by GS as what the windfall tax was going to be because they hadn't calculated it. So we in turn—we withheld from the payment that we ordinarily make to the State of that check from the State of Wyoming and it's a matter of record.

Senator **Wallop**. Well, yes, but they know that much. I don't think that was their point. I think their point was, that given this amount of money, how do we verify that you've got your share and no more?

Mr. **Petty**. We agree with them completely. It just seems an awful lot of work to put the left hand in the left-hand pocket to move the money over to the right-hand pocket.

Senator **Wallop**. Is that an enforcement by USGS of any bill to——

Mr. **Frederick**. I'm not sure that we're prepared to enforce this specifically, Senator Wallop. I think you might want to talk to the Secretary of the Interior about it. You might get a specific response.

Senator **Wallop**. Well, I'm a little worried about specific responses.

Mr. **Frederick**. We are concerned about the complexity of the—of the windfall profits and its impact on the Geological Survey and I guess our concern that we aren't able to get on top of that quicker.

We think we can work something out with the IRS, and indeed are concerned about being able to explain to the States how we calculate the amount. We estimate that it won't be 5 percent in the future. It's going to be on the order of 30 to 40 percent ultimately.

Senator **Wallop**. I have a last question. You reflected rather wistfully upon the Internal Revenue Service's computer capacity in your draft statement. As you go toward stand-alone computer capacity, are you going to coordinate those capacities; or will we have to duplicate them?

Mr. **Frederick**. Well, we think we probably will require a stand-alone capacity of our own for this particular purpose. We're looking at specific computers that are sized to handle the kind of workload that we indeed have.

The intent of our statement with regard to Internal Revenue was just to suggest that the approach that we intended to take is more or less designed on the Internal Revenue approach of a set accepting the input that we receive as accurate subject to audit. And make sure that we have machines reconciliation capability to process each and every one of those and have an audit system that—that is indeed designed to look at the most significant aspects of the information that we have received to flag problem areas. And then we will have an auditing that's ready to go out and follow up.

Senator WALLOP. There is no likely way to integrate those two capacities instead of duplicating them?

Mr. PETTY. I would doubt that the IRS would ever let an agency like ours have access to the software on their computer.

Senator WALLOP. So is yours——

Mr. PETTY. But there is ——

Senator WALLOP. For different reasons, I appreciate that.

Mr. FREDERICK. We have consulted with the Internal Revenue Service on the system itself, and in terms of design and approach and generally what—what are they looking for when they decide to audit an account and that sort of thing. We haven't gotten into specifics in terms of each and everything they include in their system, but they have talked to us about aspects.

Senator WALLOP. Well, thank you all very much.

Senator MELCHER. Mr. Chairman, Mr. Frederick's—Mr. Frederick—I'll keep the "s" off of it and use the name right. GS justifiably a very fine group of professionals with a real good history. And all professions from the very nucleus have some inspectors I suppose whom you are trying to make professional inspectors and that's a training process. But this whole procedure of an accounting, it's pretty new for GS; isn't it?

Mr. FREDERICK. Well, Senator Melcher, the procedure for accounting isn't necessarily new because it's been with us for some time.

Senator MELCHER. But all your emphasis on hiring has been for engineers and for surveyors and for professionals of that type, and so getting into accounting is a pretty tough racket for you right now; isn't it?

Mr. FREDERICK.—I think that—yes, I would—I'll agree with you generally. I think that—that for a scientific organization like the Geological Survey, perhaps who don't have the accounting instincts or haven't had the accounting instincts that——

Senator MELCHER. You've never worked in the conservation division; have you?

Mr. FREDERICK. No, sir, I came from the mapping division.

Senator MELCHER. And so the conservation division gets into the nitty-gritty now of trying to become accurate from the very basis?

Mr. FREDERICK. Yeah.

Senator MELCHER. That's why I talked about schematics. I realize it's really not your background to figure our whether there was some time there a right-of-way given—BLM gave it perhaps to bury a pipeline to lead up to a tank battery and et cetera or whether these inspectors are ever trained to know what is at a given tank battery, what—which valves are which, and where the pipes really lead to and what it means.

I realize that's kind of out of your expertise, but nevertheless, you've got to be responsible.

Mr. Frederick. Yes, sir.

Senator Melcher. Now, what about this other basic part of trying to account for the oil when it leaves the tank farm or tank battery to be sold, this run ticket business? Your people have flip-flopped from one side to the other. They told us in February very, very clearly in public hearings that a run ticket must be in the possession of the transporter of the oil. They said either it had to be with the trucker or in some cases maybe it had to be left at the battery or at the tank site location right on the lease.

Now your people, your solicitors, are telling us differently; are they not?

Mr. Frederick. I'm not sure that it's the solicitors that are telling you differerent. At the moment I believe there—our people suggested to you yesterday perhaps, and maybe even earlier, that we didn't have the authority to require that the run tickets be available in the tank trucks. The run ticket is required. It's a question of whether it's required immediately upon sale at the—at the site of the exchange or whether it's——

Senator Melcher. I want to clear up that "upon sale" immediately because I think some people might think you're talking about money changing hands. It doesn't change hands at that point at all; does it?

Mr. Frederick. No, sir. No, sir, that's exchanged——

Senator Melcher. So the run ticket is really a document that won't prove ownership until——

Mr. Frederick: Yes, sir.

Senator Melcher. [continuing] Until such time as designation of the oil——

Mr. Frederick. Yes, sir.

Senator Melcher. [continuing] For when it will be put in the accounting system to finally make it a payment; isn't that correct?

Mr. Frederick. Well, the run ticket is received of the exchanging out of that system into a totally different system. It's used for verification purposes.

Senator Melcher. Well, the run ticket is not required then to be in the possession of the trucker or in the possession of the pumper at the——

Mr. Frederick. It is required that—we believe it is indeed required.

Senator Melcher. Where?

Mr. Frederick. At the lease.

Senator Melcher. At the lease?

Mr. Frederick. At the—at the—with the pumper.

Senator Melcher. With the pumper?

Mr. Frederick: Yes, sir.

Mr. Melcher. A copy of it is to be with the pumper?

Mr. Frederick. Yes, we believe that's the case.

Senator Melcher. All right. Now——

Mr. Frederick. Also, Senator Melcher, we indeed—indeed intend to clarify our people's understanding of that, and we'll follow that through.

Senator Melcher. How about accompanying the truck?

Mr. Frederick. We're not sure we have the authority to do that but we will pursue it.

Senator **Melcher**. Seems rather elementary.

Mr. **Frederick**. Well, it's all a matter of—again, I guess the responsibilities of the Geological Survey. Our responsibilities don't extend beyond the lease in terms of—in terms of assuring——

Senator **Melcher**. How come all this testimony we have mentions going back for at least 10 years saying it's absolutely required? We received testimony in February saying it's required; we received testimony from the GS in April saying it's required. How come it varies? Is there something changed in the law?

Mr. **Frederick**. I don't think so, Senator Melcher. If indeed there is discrepancies, it's different understandings of—of indeed the explicit authority that we have.

Senator **Melcher**. Well, all right. I understand Mr. Simms has sent you some suggestions along this line.

Mr. **Frederick**. Yes, he has. And he shared those with me this morning.

Senator **Melcher**. Now, one last question. Are Lynn Henson, George Campbell, and Roy Harrison, all employees of the GS in Reston now for a specific purpose?

Mr. **Frederick**. I'm not sure that I can say yes. I think so. We are—if your question is are we establishing a quality assurance team to—to follow up, to check on our people's understanding of the regulations and to assure that—that they are indeed following—being followed, yes, that's true. And that's something I should have mentioned earlier.

We are establishing a quality assurance team, and I believe those individuals that you listed are to be members of that team; although, I couldn't—couldn't verify that specifically.

Senator **Melcher**. Can I use what we generally do, initials? That's a QAT?

Mr. **Frederick**. We'll be a little more reverent about the team than that.

Senator **Melcher**. Quality assessment team. I like that. The QAT. Sort of like SWAT. I thought it was going to be a strike force or something—something a little more dramatic. You're going to call them a quality assessment team?

Mr. **Frederick**. Quality assurance team.

Senator **Melcher**. Quality assurance team.

Mr. **Frederick**. Yes, sir.

Senator **Melcher**. They are to find out whether or not these inspections in the field are done adequately. Is that it?

Mr. **Frederick**. Essentially it's our internal audit on those inspections to make sure that our regulations are clear, our people understand them, our communications are being properly disseminated down through the system to those that have to inspect.

They are also to assure that the people are looking for the right thing, and that they see it.

Senator **Melcher**. They are—I get confused by this term "audit." They are going on to the lease property to check whether or not inspections are made properly?

Mr. **Frederick**. Mostly, Senator Melcher, they are to look at our procedures to make sure our people understand what to look for rather than the——

Senator **Melcher**. The procedures of the inspectors?

Mr. **Frederick**. Yes, sir, and the knowledge of the inspectors.

Senator **Melcher**. Yes, all right. Thank you very much.

Mr. **Frederick**. Yes, sir.

Senator **Wallop**. Much obliged, Mr. Frederick. The next is Hon. Jim Griffith, State auditor of Wyoming, my long-time friend in politics.

Jim, welcome.

STATEMENT OF JIM GRIFFITH, WYOMING STATE AUDITOR

Mr. **Griffith**, Well, thank you. Senator Wallop. Senator Melcher, staff, ladies and gentlemen, it's—frankly my testimony really is a summary. I'm Jim Griffith, the Wyoming State auditor. And I thank you very much for the opportunity to appear here today.

The problem of collection, accounting and distribution of mineral royalities is of great concern to me, and I think of most of the rest of the people of Wyoming. Because of the magnitude of the monies involved, the problem could well be one of a national significance.

During the 46th session of the Wyoming legislature, which met ealier this year, a bill was introduced, passed, and signed into law whereby my office would conduct audits of the extractive industries operating in Wyoming. A staff of three has now been employed. A fourth member of the team will be on board later this month. We are beginning earnestly with the intensity to conduct these audits. The effort started July 1, 1981. It was not the intent of the sponsor of this bill nor I believe of the legislature as a whole that this staff be limited to such a small number, but that our procedures be established and a determination made if, in fact, there is a need for such a program.

We are just now completing our second audit. In our first and very small effort, a single small gas well producing from a State lease was audited. And in this small well we found variances of from 5 percent to 600 percent among gas production figures reported to various State agencies. The lowest of the reported figures was the one whereby the company computed royalties due to the State. We were able to determine what we believe was the actual production and expect soon that we will recover a few thousand dollars due in royalties.

In our second audit of a large oil and gas unit we've discovered that the unit operator and the three major oil purchasers have each been—have been computing and using different total sales figures every month since the inception of the audit or since the inception of the unit. While I am at present unable to report with any certainty the amount which the State has been shorted, it is likely that it will be considerable.

Our auditors will be testing reported mineral production figures, reconciling reports among State agencies, and physically monitoring the taking and movement of minerals produced from Wyoming. Our mineral production audit group is and will be developing controls within our State agencies to assure the proper receiving, accounting, and distribution of royalty and other moneys coming to the State from the production of oil, gas, coal, trona, sand and gravel, bentonite, limestone, and other valuable minerals. It is my intent that our audits not be confined to paperwork, but include such activities as dipping tanks, monitoring meter flows, and onsite surveillance.

Even though we've only been in the actual process for slightly over a month, I believe I can inform you with certainty that there is a most definite need for this type of audit program, I wish to point out that the cooperation we have received from the oil and gas firms we have worked with could not have been better. In fact, at least one company expressed appreciation for our work in order that they could more correctly report payments due.

Wyoming owns approximately 3.6 million surface acres. By contrast, the Federal Government owns approximately 30 million acres. Of this approximately 30 million acres, the Bureau of Land Management administers approximately 17.8 million acres. The remainder is administered mostly by the Forest Service, the Parks Service, and the Bureau of Indian Affairs. Therefore, it can be assumed that if a State auditing program is important, it is many times more important that the Federal Government receive what is rightfully due them. You won't be able to balance the budget, you won't solve the social security problems, but the moneys collected should be significant. Of course, Wyoming would like its full 50 percent share of the Federal mineral royalties.

Now, I—I understand that earlier today that the Department of the Interior and GS and so forth started to work on an accounting system for the mineral royalties. But this system will not be in operation until 1984 at least, maybe later. That seems like an awful long time, and I would suggest that it won't be effective unless it includes audit capabilities. I would suggest to you that the Internal Revenue Service might not be collecting as much income tax from the American people if everyone were certain their return would not be checked or audited. There is a definite correlation. Auditing is a necessary preventive device.

Perhaps I am impatient, but I also believe that I am realistic. I feel that 1984 is too much of a time lag to solve this problem. There is no doubt that we, both the United States and the State of Wyoming, have lost royalty money which, because of the passage of time, will never be recovered. The sooner you begin to act, and, yes, to fund an auditing, as well as an accounting program, the less money we will continue to lose.

Wyoming's population increased 41.1 percent during the seventies, and I am certain that most of that was during the latter half of the decade. Forecasts are that the population will nearly double between now and 1990. Wyoming's impact problems are severe and will continue. It is with the mineral royalty money that the State of Wyoming plans to help alleviate the impact problems.

It is my suspicion that the State of California's lawsuit against the Secretary of the Interior is more politically inspired than designed to solve the problem. Because of the system, or lack of system the Secretary of the Interior inherited, it is not possible for the Secretary to accurately tell California just how much revenue they have lost in the past year. This is unforutnate. It must be corrected. Even though the State of Wyoming has been asked to join the lawsuit, I, for one, declined. We do not wish to be part of the problem by causing delays which lawsuits seem to inevitably do. We wish to pitch in and help solve the problem.

I foresee a partnership developing between the public lands, States to the west, and the Federal Government. And I hope that Mr. Frederick will contact Wyoming or we will contact him so we can get immediate operations, for we both have so much to gain.

We of the State of Wyoming have started to put our house in order in order that we might receive our full share of mineral royalties, and I suggest that the Federal Government move rapidly to get their house in order. Thank you.

[The prepared statement of Mr. Griffith follows:]

SENATOR WALLOP, SENATOR MELCHER, STAFF MEMBERS, LADIES AND GENTLEMEN:

I'M JIM GRIFFITH, WYOMING STATE AUDITOR. THANK YOU VERY MUCH FOR THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY. THE PROBLEM OF COLLECTION, ACCOUNTING AND DISTRIBUTION OF MINERAL ROYALTIES IS OF GREAT CONCERN TO ME AND MOST OTHER PEOPLE OF WYOMING. BECAUSE OF THE MAGNITUDE OF THE MONIES INVOLVED, THE PROBLEM COULD WELL BE OF NATIONAL SIGNIFICANCE.

DURING THE 46TH SESSION OF THE WYOMING LEGISLATURE, WHICH MET EARLIER THIS YEAR, A BILL WAS INTRODUCED, PASSED AND SIGNED INTO LAW WHEREBY MY OFFICE WOULD CONDUCT AUDITS OF THE EXTRACTIVE INDUSTRIES OPERATING IN WYOMING. A STAFF OF THREE HAS NOW BEEN EMPLOYED. A FOURTH MEMBER OF THE TEAM WILL BE ON BOARD LATER THIS MONTH. WE ARE BEGINNING EARNESTLY AND WITH INTENSITY TO CONDUCT THESE AUDITS. THE EFFORT STARTED JULY 1, 1981. IT WAS NOT THE INTENT OF THE SPONSOR OF THE BILL, NOR THE LEGISLATURE AS A WHOLE, THAT THIS STAFF BE LIMITED TO SUCH A SMALL NUMBER, BUT THAT THE AUDIT PROCEDURES BE ESTABLISHED AND A DETERMINATION MADE IF, IN FACT, THERE IS A NEED FOR SUCH A PROGRAM.

WE ARE JUST NOW COMPLETING OUR SECOND AUDIT. IN OUR FIRST AND VERY SMALL EFFORT, A SINGLE SMALL GAS WELL PRODUCING FROM A STATE LEASE WAS AUDITED. IN THIS SMALL WELL, WE FOUND VARIANCES OF FROM 5% TO 600% AMONG GAS PRODUCTION FIGURES REPORTED TO THE VARIOUS STATE AGENCIES. THE LOWEST OF THE REPORTED FIGURES WAS THE ONE WHEREBY THE COMPANY COMPUTED ROYALTIES DUE THE STATE. WE WERE ABLE TO DETERMINE THE ACTUAL PRODUCTION, AND

EXPECT SOON THAT WE WILL RECOVER A FEW THOUSAND DOLLARS DUE IN ROYALTIES.

IN OUR SECOND AUDIT OF A LARGE OIL AND GAS UNIT, WE HAVE DISCOVERED THAT THE UNIT OPERATOR AND THE THREE MAJOR OIL PURCHASERS HAVE EACH BEEN COMPUTING AND USING DIFFERENT TOTAL SALES FIGURES EVERY MONTH SINCE THE INCEPTION OF THE UNIT. WHILE I AM AT PRESENT UNABLE TO REPORT WITH ANY CERTAINTY THE AMOUNT WHICH THE STATE HAS BEEN SHORTED, IT IS LIKELY THAT IT WILL BE CONSIDERABLE.

OUR AUDITORS WILL BE TESTING REPORTED MINERAL PRODUCTION FIGURES, RECONCILING REPORTS AMONG STATE AGENCIES AND PHYSICALLY MONITORING THE TAKING AND MOVEMENT OF MINERALS PRODUCED FROM WYOMING. OUR MINERAL PRODUCTION AUDIT GROUP IS AND WILL BE DEVELOPING CONTROLS WITHIN OUR STATE AGENCIES TO ASSURE THE PROPER RECEIPTING, ACCOUNTING AND DISTRIBUTION OF ROYALTY AND OTHER MONIES COMING TO THE STATE FROM THE PRODUCTION OF OIL, GAS, COAL, TRONA, SAND AND GRAVEL, BENTONITE, LIMESTONE AND OTHER VALUABLE MINERALS. IT IS MY INTENT THAT OUR AUDITS NOT BE CONFINED TO PAPER WORK, BUT INCLUDE SUCH ACTIVITIES AS DIPPING TANKS, MONITORING METER FLOWS AND ON-SITE SURVEILLANCE.

EVEN THOUGH WE HAVE ONLY BEEN IN THE ACTUAL PROCESS FOR SLIGHTLY OVER A MONTH, I BELIEVE I CAN INFORM YOU WITH CERTAINTY THAT THERE IS MOST DEFINITELY A NEED FOR AN AUDIT PROGRAM OF THIS NATURE. I ALSO WISH TO POINT OUT THAT THE COOPERATION WE HAVE RECEIVED FROM THE TEN OIL AND GAS FIRMS WE HAVE WORKED WITH COULD NOT HAVE BEEN BETTER.

IN FACT, IN AT LEAST ONE CASE, A COMPANY EXPRESSED APPRECIATION FOR OUR WORK IN ORDER THAT THEY COULD MORE CORRECTLY REPORT PAYMENTS DUE.

WYOMING OWNS APPROXIMATELY 3.6 MILLION SURFACE ACRES. BY CONTRAST, THE FEDERAL GOVERNMENT OWNS APPROXIMATELY 30 MILLION ACRES. OF THIS APPROXIMATELY 30 MILLION ACRES, THE BUREAU OF LAND MANAGEMENT ADMINISTERS APPROXIMATELY 17.8 MILLION ACRES. THE REMAINDER IS ADMINISTERED MOSTLY BY THE FOREST SERVICE, THE PARK SERVICE AND BUREAU OF INDIAN AFFAIRS. THEREFORE, IT CAN BE ASSUMED THAT IF A STATE AUDITING PROGRAM IS IMPORTANT, IT IS MANY TIMES MORE IMPORTANT THAT THE FEDERAL GOVERNMENT RECEIVE WHAT IS RIGHTFULLY DUE THEM. YOU WON'T BE ABLE TO BALANCE THE BUDGET, YOU WON'T SOLVE THE SOCIAL SECURITY PROBLEMS, BUT THE MONIES COLLECTED SHOULD BE SIGNIFICANT. OF COURSE, WYOMING WOULD LIKE ITS FULL 50% SHARE OF THE ROYALTIES FROM MINERAL PRODUCTION ON FEDERAL LANDS LOCATED WITHIN THE BORDERS OF WYOMING.

IT IS MY UNDERSTANDING THAT THE DEPARTMENT OF THE INTERIOR HAS STARTED TO WORK ON AN ACCOUNTING SYSTEM FOR THE REPORTING OF MINERAL ROYALTIES, BUT THAT THIS SYSTEM WILL NOT BE OPERATIVE UNTIL AT LEAST 1984. EVEN AFTER THIS SYSTEM BECOMES OPERATIVE, IT WILL NOT PROPERLY FUNCTION UNLESS IT INCLUDES AUDIT CAPABILITIES. I WOULD SUGGEST TO YOU THAT THE INTERNAL REVENUE SERVICE MIGHT NOT BE COLLECTING AS MUCH INCOME TAX FROM THE AMERICAN PEOPLE IF EVERYONE WERE CERTAIN THEIR RETURN WOULD NOT BE CHECKED OR AUDITED. THERE IS A DEFINITE CORRELATION. AUDITING IS A NECESSARY PREVENTATIVE DEVICE.

PERHAPS I AM IMPATIENT, BUT I ALSO BELIEVE THAT I AM REALISTIC. I FEEL THAT 1984 IS TOO MUCH OF A TIME LAG TO SOLVE THIS PROBLEM. THERE IS NO DOUBT THAT WE, BOTH THE UNITED STATES AND THE STATE OF WYOMING, HAVE LOST ROYALTY MONEY WHICH, BECAUSE OF THE PASSAGE OF TIME, WILL NEVER BE RECOVERED. THE SOONER YOU BEGIN TO ACT, AND YES, TO FUND, AN AUDITING, AS WELL AS AN ACCOUNTING PROGRAM, THE LESS MONEY WE WILL CONTINUE TO LOSE.

WYOMING'S POPULATION INCREASED 41.1 PERCENT DURING THE 70'S, AND I AM CERTAIN THAT MOST OF THAT WAS DURING THE LATTER HALF OF THE DECADE. FORECASTS ARE THAT THE POPULATION WILL NEARLY DOUBLE BETWEEN NOW AND 1990. WYOMING'S IMPACT PROBLEMS ARE SEVERE, AND WILL CONTINUE. IT IS WITH THE MINERAL ROYALTY MONEY THAT THE STATE OF WYOMING PLANS TO HELP ALLEVIATE THE IMPACT PROBLEMS.

IT IS MY SUSPICION THAT THE STATE OF CALIFORNIA'S LAWSUIT AGAINST THE SECRETARY OF THE INTERIOR IS MORE POLITICALLY INSPIRED THAN DESIGNED TO SOLVE THE PROBLEM. BECAUSE OF THE SYSTEM, OR LACK OF SYSTEM THE SECRETARY OF INTERIOR INHERITED, IT IS NOT POSSIBLE FOR THE SECRETARY TO ACCURATELY TELL CALIFORNIA JUST HOW MUCH REVENUE THEY HAVE LOST IN PAST YEARS. THIS IS UNFORTUNATE, AND IT MUST BE CORRECTED. EVEN THOUGH THE STATE OF WYOMING WAS ASKED TO JOIN IN THE LAWSUIT, I, FOR ONE, DECLINED. WE DO NOT WISH TO BE PART OF THE PROBLEM BY CAUSING DELAYS WHICH LAWSUITS SEEM TO INEVITABLY DO. WE WISH TO PITCH IN AND HELP SOLVE THE PROBLEM.

I FORESEE A PARTNERSHIP DEVELOPING BETWEEN THE PUBLIC LAND STATES OF THE WEST AND THE FEDERAL GOVERNMENT. WE BOTH HAVE SO MUCH TO GAIN. THE STATE OF WYOMING HAS ALREADY STARTED TO PUT ITS HOUSE IN ORDER TO DETERMINE THAT WE ARE RECEIVING OUR RIGHTFUL SHARE OF MINERAL ROYALTY AND OTHER MONIES. I SUGGEST THAT THE FEDERAL GOVERNMENT ALSO BEGIN TO PUT ITS HOUSE IN ORDER.

THANK YOU.

Senator WALLOP. Than you, Jim. I think that that certainly is Secretary Watt's desire in all of this in creating and establishing the Blue Ribbon Commission.

Mr. GRIFFITH. I'm pleased, and I hope you'll work with us.

Senator WALLOP. John, do you have any questions?

Senator MELCHER. I'm just going to suggest to our State officials, our Government, and the State legislatures that we keep track of exactly what you're doing, Mr. Griffith, because I think whatever you are doing down here that makes sense is going to make sense in Montana too.

Mr. GRIFFITH. Well, I'm sure it will. I said we had 3.6 million acres of State lands, and yours runs many times that.

Senator MELCHER. Ten times as much.

Mr. GRIFFITH. But nevertheless, it's important. I'm going to pay for my biennial budget in the first few months I believe.

Senator MELCHER. That is important.

Mr. GRIFFITH. Yes, sir.

Senator WALLOP. Jim, I really appreciate your taking time to share that with us. And I think that the USGS would find your aduit procedures at least appealing. They ought to pay attention to it if for no other reason than that it seems already to be working as you described. Even though it's a small and tentative staff, it would seem as though it would be worthwhile to get some of these internal procedures on line as quickly——

Mr. GRIFFITH. We're going to try—at the same time we're trying to redesign the land offices at the county system. So our problem is the same as yours except smaller.

Senator WALLOP. We'll take a 5-minute break now and come back at 4 o'clock.

[Recess taken.]

Senator WALLOP. Next is the panel from the Shoshoni and Arapahoe Tribes, starting with Mr. John Washakie, member of the Shoshoni Business Council; Pat Goggles, member of the Arapahoe Business Council; Leonard Moss, director of Joint Tribal Minerals Department; Mr. Saul Goodman, an attorney from Rogovin, Huge & Lenzner.

Welcome here, and I appreciate your taking time to come down and share with us your concerns and experiences.

STATEMENT OF JOHN WASHAKIE, MEMBER OF THE SHOSHONI BUSINESS COUNCIL; ACCOMPANIED BY PAT GOGGLES, MEMBER OF THE ARAPAHOE BUSINESS COUNCIL; LEONARD MOSS, DIRECTOR OF JOINT TRIBAL MINERALS DEPARTMENT; AND SAUL GOODMAN, ESQ., ATTORNEY, ROGOVIN, HUGE & LENZNER

Mr. WASHAKIE. Thank you. On behalf of the Shoshoni and Arapahoe Tribes, I would like to thank both Senator Wallop and Senator Melcher for this opportunity to testify before the Senate Committee on Energy and Natural Resources. Our testimony will address the royalty accounting problems we now face on the Wind River Reservation and the prospect of solving these problems under the new USGS royalty management program.

This issue is very important to the tribes since we derive substantial royalty income from our active 99 oil and gas leases. At the outset I would like to introduce us and let you know who we are. The far right is Pat Goggles, a member of the Arapahoe Business Council. To my immediate right is Saul Goodman, an attorney with the Washakie law firm of Rogovin, Huge & Lenzner. To my left is Leonard Moss, the Shoshoni and Arapahoe tribal mineral director.

Last February the tribes testified before Senator Melcher's hearing at the—in Billings, Mont. Our testimony addressed the adequacy of the USGS inspection program and royalty accounting system then in place on the Wind River Reservation. Citing acute understaffing and inficient operations within the USGS, we concluded that the present system of managing tribal leases is wholly inadequate to insure the correct amount of royalties is being paid on oil and gas production. The results, we told Senator Melcher, is that the door is often left open on tribal leases to theft and underpayment of royalties.

Since last February we believe that our joint tribal investigation of the oil and gas fields on the Wind River Reservation has dramatically demonstrated that our tentative conclusions outlined in Billings were right on the mark. As a result of our investigations, the tribes have received more—more than $1 billion in previously unpaid royalties. The lessees have repeatedly attributed these underpayments to so-called accounting errors. Whether the underpayments are in fact the result of mere accounting errors remains to be seen. But the important point for our purposes today is that, had it not been for the tribes' own investigation and the publicity surrounding it, we seriously doubt that the tribes would ever have received their proper royalties.

Time after time the underpayments on the Wind River leases were discovered not as a result of the USGS royalty accounting system, but rather as a result of the work of tribal investigators. The reason is simple. The present royalty accounting system is little more than a billing device dependent almost entirely on the information submitted by the lessee producers. Although the present system is computerized, it is inadequate to detect the obvious errors, shortcomings, and corruption in the accounting system used by the oil companies. Moreover, even when USGS auditors are called in to review individual lease accounts, they're hampered by inadequate staffing, lack of data processing support, and inadequate information. In short, the present USGS royalty accounting system is terribly flawed.

The tribes thought it might be useful to the committee in assessing the adequacy of the new royalty management program now being developed to illustrate a few of the problems we have encountered with the present system. These problems are outlined in—in detail in our written submission to the committee; but we believe they are as follows: One problem is that the data processing capabilities of the present system are substantially underutilized because important information routinely filed with the USGS, particularly well-by-well data, is not fed into the USGS computer.

A second problem with the present system is that the information that is fed into the computer, particularly pricing data, is not adequately reconciled.

A third problem with the present royalty accounting system is that it is not adequately coordinated with the USGS inspection program.

A fourth problem is that the present royalty accounting system places excessive reliance on the accuracy of the production sales and royalty data submitted by the lessees.

This information is rarely, if ever, checked for accuracies against primary documents such as run tickets, LACT tickets, or gage reports.

And yet a fifth problem with the royalty accounting system is undue delay in collecting these delinquent accounts.

The cumulative effect of these problems is that during the course of our joint tribal investigation we have discovered more than $1 million in unpaid royalties. The foregoing problems that the tribes have encountered with the present royalty accounting system are outlined here to provide the committee with a benchmark against which to measure the promise of the new royalty management program.

The tribes are doubtful, however, that the new program will in fact solve the problems that now exist. The tribes have three principal concerns with the new royalty management program. The first concern is that the new program, at least for the next 2 years, will really be nothing more than a rehash of the present system. Although the leases will have different code numbers, the tribes understand that the basic computer program underlying the new system will be essentially the same as that being used now.

If so, the tribes foresee no short-term relief from the accounting problems discovered during the investigation. Although USGS now plans to introduce more sophisticated programs into the royalty accounting system beginning in 1983, the problem is that to date these plans are hardly on the drawing board. The tribes believe strongly that this planning process must be expedited.

The second concern of the tribe—tribes is that the new royalty management program will aggravate the present lack of coordination between the USGS inspection program and the royalty accounting system. It is the tribes' understanding that under the new royalty management program the inspection and the accounting function will be administered under different lines of responsibility within the USGS. To so divide these lines of responsibility is almost certain to reduce communication between those USGS employees with first-hand knowledge of the operation of the oilfields. And those who are responsible for insuring the operation of the oilfields are—are reflected—excuse me—and those who are responsible for insuring that the operations of the oilfields are—are reflected in proper royalty payments. The tribes regard this as a clear step in the wrong direction.

The tribes' third concern is that the new royalty accounting program, which is heavily dependent on auditing, will not be staffed with enough auditors. The entire audit staff of the USGS office in Casper, which is responsible for auditing nearly 7,600 lease accounts, has spent several months in auditing the 99 tribal leases on the Wind River Reservation. It is readily apparent, therefore, that far more auditors than currently planned are needed to put teeth in the auditing phase of the new royalty management program.

In conclusion, the day has come when the million-dollar accounting errors must end. Although there are talented and dedicated people working in the USGS inspection program and royalty accounting system, they are understaffed, underutilized, and oversupervised. The result is that the present system of managing tribal lease accounts is simply not working.

It is the hope of the Shoshoni and Arapahoe tribes that the USGS will devise an improved royalty management program that will remedy the problems that have plagued the tribes in the past. In all candor, however, the tribes are doubtful that the present plan for the new royalty management program will meet those expectations. Accordingly, the tribes believe that this committee's continued participation is essential to insure that USGS corrects the glaring deficiencies in the present royalty accounting system.

[The prepared statement of Mr. Washakie follows:]

TESTIMONY OF THE SHOSHONE AND ARAPAHOE TRIBES OF THE WIND RIVER RESERVATION BEFORE THE SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

CASPER, WYOMING

AUGUST 11, 1981

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THE SHOSHONE BUSINESS COUNCIL

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The Shoshone and Arapahoe Tribes are the joint lessors of 99 active oil and natural gas leases on the Wind River Reservation in Wyoming. In light of the substantial revenues derived from these oil and gas leases, the Tribes greatly appreciate this opportunity to address the Senate Committee on Energy and Natural Resources regarding the royalty accounting problems we now face on the Wind River Reservation and the prospects for solving these problems under the new USGS royalty management program.

I. THE PRESENT ROYALTY ACCOUNTING SYSTEM

Last February, the Tribes testified before Senator Melcher at a hearing of the Senate Select Committee on Indian Affairs in Billings, Montana. Our testimony addressed the adequacy of the USGS inspection program and royalty accounting system then in place on the Wind River Reservation. Citing acute understaffing and inefficient operations within the USGS, we concluded that "the present system of managing tribal leases is wholly inadequate to ensure that the correct amount of royalties is paid on oil and gas production." "The result," we told Senator Melcher "is that the door is often left open on tribal leases to theft and underpayments of royalties."

Since last February, we believe that our joint tribal investigation of the oil and gas fields on the Wind River Reservation has dramatically demonstrated that our tentative conclusions outlined in Billings were right on the mark. As a result of our investigation, the Tribes have received more than $1 million in previously unpaid royalties. The lessees have repeatedly attributed these underpayments to so-called "accounting errors." Whether the underpayments are in fact the result of mere accounting errors remains to be seen. But the important point for our purposes today is that, had it not been for the Tribes' own investigation and the publicity surrounding it, we seriously doubt that the Tribes would ever have received their proper royalties.

Time, after time, the underpayments on Wind River leases were discovered not as a result of the USGS royalty accounting system, but rather as a result of work by tribal investigators. The reason is simple: The present royalty accounting system is little more than a billing device dependent almost entirely on information submitted by the lessee producers. Although the present system is computerized, it is woefully inadequate to detect the obvious errors, shortcomings, and corruptions in the accounting systems used by the oil companies. Moreover, even when USGS auditors are called in to review individual lease accounts, they are hampered by inadequate staffing, lack of data processing support, and inadequate information. In short, the present USGS royalty accounting system is terribly flawed.

II. PROBLEMS TO BE REMEDIED

The Tribes thought it might be useful to the Committee, in assessing the adequacy of the new royalty management program now being developed, to illustrate a few of the problems we have encountered with the present system.

One problem is that the data-processing capabilities of the present system are substantially underutilized because important information routinely filed with the USGS is not fed into the USGS computer. For example, the USGS presently requires every lessee to submit three reports each month concerning production, sales, and royalties for every federal and Indian lease. Two of these reports are fed into the computerized royalty accounting system. But the third, which is the only report with well-by-well data, is not entered into the computer system at all, but rather filed away for use principally by USGS engineers, not accountants. Tribal investigators have uncovered literally hundreds of thousands of dollars of unpaid royalties simply by finding inconsistencies in the reports already on file with the USGS. This sort of reconciliation could and should be done by computer.

The computer should also be tied into the basic data relating to the terms of the leases. With regard to one lease on our Reservation, there is a substantial question whether the lessee began producing gas in paying quantities within the initial ten-year period of the lease. If not, the lease lapsed, by its own terms, many years ago, and ever since then, the lessee has been wrongfully removing gas from tribal lands without a valid lease. This sort of problem could also be easily avoided by appropriate use of the computerized royalty accounting system.

A second problem with the present system is that the information that is fed into the computer is not adequately reconciled. One important reconciliation that should be done by the computer relates to pricing. The tribal leases on the Wind River Reservation require lessees to pay royalties based on a percentage of the maximum allowable sales price. However, on one oil field on the Reservation where there are several lessees, it was discovered during an audit that the lessees were routinely computing royalties based on different sale prices for the same grade crude oil. These discrepancies resulted in an underpayment of almost $100,000 in tribal royalties over a three-year period. If the computer system had been programmed to conduct a simple pricing reconciliation for the lessees on the same field, this problem would have been easily detected without recourse to a time-consuming and costly audit.

A third problem with the present royalty accounting system is that it is not adequately coordinated with the USGS inspection program. During our investigation we have learned that detailed field inspections are essential to ensuring the accuracy of the royalty accounting system. For example, on one oil field on the Reservation, tribal investigators discovered that more than 450,000 barrels of oil produced on certain tribal wells over a nine-year period were not credited to tribal accounts. This resulted in an underpayment of tribal royalties in excess of $750,000. To avoid this sort of problem in the future, the USGS computer system should be programmed to match well-by-well production reports with an inventory of wells that, as a result of USGS field inspections, are known to be producing on specific leases.

A fourth problem is that the present royalty accounting system places excessive reliance on the accuracy of the production, sales, and royalty data submitted by the lessees. This information is rarely, if ever, checked for accuracy against primary documents, such as run tickets, LACT tickets, or gauge reports. During the course of our investigation, we have discovered significant discrepancies in several lease accounts that could not have been detected other than by review of the primary documents. For example, in reviewing the records of one lessee on the Reservation, tribal investigators noticed that the lessee had "misplaced" certain LACT ticket data for which the Tribes had not received royalties on crude oil sales worth more than $100,000. If USGS is ever to conduct the detailed audit work necessary to detect this sort of discrepancy, it certainly will need far more auditors than are presently working on Wind River accounts.

Yet a fifth problem with the royalty accounting system is undue delay in correcting delinquent accounts. In one instance on a Wind River lease, the USGS failed to pursue payment of $136,000 in royalties that had been overdue for more than six months. In another instance, a lessee, during a five-month period, was permitted to miss two monthly payments altogether and to submit two others late before USGS first contacted the lessee about its failure to pay royalties in timely fashion. Moreover, even after the lessee was contacted, the lessee failed to submit royalty payments in four of the next six months.

The recently-adopted regulations that impose an interest penalty for late royalty payments should alleviate this problem to a large extent. But, notwithstanding the fact that the regulations became effective on March 30, 1981, and that more than $500,000 in tribal royalties were received late during the first two months of the new regulations, the USGS has yet to assess an interest penalty against any of the lessees on the Wind River Reservation.

III. THE NEW ROYALTY MANAGEMENT PROGRAM

The foregoing problems that the Tribes have encountered with the present royalty accounting system are outlined here to provide the Committee with a benchmark against which to measure the promise of the new royalty management program. The Tribes are doubtful, however, that the new program will in fact solve the problems that now exist.

The Tribes have three principal concerns with the new royalty management program. The first concern is that the new program, at least for the next two years, will really be nothing more than a rehash of the present system. Although the leases will have different code numbers, the Tribes understand that the basic computer program underlying the new system will be essentially the same as that now being used. If so, the Tribes foresee no short-term relief from the accounting problems discovered during the investigation.

Although USGS now plans to introduce more sophisticated programming into the royalty accounting system beginning in 1983, the problem is that, to date, these plans are hardly on the drawing board. The Tribes believe strongly that this planning process must be expedited.

The second concern of the Tribes is that the new royalty management program will exacerbate the present lack of coordination between the USGS inspection program and royalty accounting system. It is the Tribes' understanding that, under the new royalty management program, the inspection and accounting functions will be administered under different lines of responsibility within the USGS. To so divide these lines of responsibility is almost certain to reduce communication between those USGS employees with first-hand knowledge of the operations of the oil fields and those who are responsible for ensuring that the operations of the oil fields are reflected in proper royalty payments. The Tribes regard this as a clear step in the wrong direction.

The Tribes' third concern is that the new royalty accounting program, which is heavily dependent on auditing, will not be staffed with enough auditors. The entire audit staff of the USGS office in Casper, which is responsible for auditing nearly 7,600 lease accounts, has spent several months in auditing the 99 tribal leases on the Wind River Reservation. It is readily apparent, therefore, that far more auditors than currently planned are needed to put teeth in the auditing phase of the new royalty management program.

IV. CONCLUSION

The day has come when the $1 million "accounting errors" must end. Although there are talented and dedicated people working in the USGS inspection program and royalty accounting system, they are understaffed, underutilized, and over-supervised. The result is that the present system of managing tribal lease accounts is simply not working.

It is the hope of the Shoshone and Arapahoe Tribes that the USGS will devise an improved royalty management program that will remedy the problems that have plagued the Tribes in the past. In all candor, however, the Tribes are doubtful that the present plans for the new royalty management program will meet those expectations. Accordingly, the Tribes believe that this Committee's continued participation is essential to ensure that USGS corrects the glaring deficiencies in the present royalty accounting system.

Senator WALLOP. John, thank you very much. Do you have a statement, Pat?

Mr. GOGGLES. No, Senator Wallop.

Senator WALLOP. John?

Senator MELCHER. Well, I liked the statement because I think it demonstrates that the Wind River tribes have really been biting the bullet in trying to figure out what to do. Now, I think you pinpointed something I've always been concerned about since we started looking at this. If you don't start with basic information on what these individual wells are supposed to produce and what they actually do produce and then feed that into the whole accounting system, I don't know where you start. I think that's what I said; start at the wellhead.

Well, of course, Senator Wallop pointed out about the water at the well; it's got to be separated out and sold. But nevertheless, you've got to know that what you are pumping out of a well is going to go into a storage tank. That individual well does begin the whole process for each lease.

Have you got 99 leases? Is that what the tribes are involved in?

Mr. WASHAKIE. Yes; we do.

Senator MELCHER. What if the tribes pursued the policy that the Osage have adopted; they do their own accounting, their own monitoring. I know you've thought of that, but are there some shortcomings in following that for the tribes?

Mr. WASHAKIE. At the present time we've sent some people down there to really look at what the Osage are doing. However, we have not fully evaluated their program to—to that extent. We're still investigating some aspects of it ourselves, and we hope to have a minerals department that will at least be adequate and assure the proper royalties are being paid.

We also had to go into other areas that we're now looking at such as what areas we want to put up for bid and things like that.

Senator MELCHER. Thank you, John.

Senator WALLOP. John, again I compliment you on the statement. I would like to ask you, while you are in the process of trying to do something on behalf of the tribes in this interim period, if it has occurred to you to perhaps do what the State auditor, Jim Griffith, has done?

Mr. WASHAKIE. Well, we have not had contact with his office, Senator; so we hope to look at all aspects of it. We—we didn't know that the State had gotten involved. We had heard that they had decided not to enter into the suit with California, but then he mentioned that last month they had gotten involved in this program.

Senator WALLOP. I just was sort of impressed with what they've done in a short period of time. I'm sure they would be cordial in at least showing you how it was designed if that was of any interest.

What are you doing now about your accounting problems, John?

Mr. WASHAKIE. I'd like Pat to answer that.

Mr. GOGGLES. I'll answer that for you, Senator Wallop and Senator Melcher. As—as you all know, the tribes initiated in November an investigation of their own. In initiating that investigation, we required expert services. We retained the law firm of Rogovin, Huge & Lenzner, in Washington, D.C. We also went out and hired the nationally known accounting firm of Touche, Ross & Co. in Denver, Colo. We also did hire former USGS employee Charles Thomas. He played a very important role in our investigation, has since left for the Blackfoot Reservation. We have also established a minerals department, and I'll briefly let Leonard Moss tell you about the activities of the minerals department. Leonard.

Mr. Moss. Senator Melcher, our minerals department is responsible for monitoring tribal leases and—by means of our conducting our own field inspections. And our goal is to insure that oil and gas companies comply with USGS regulations and pay the proper royalties. Basically that is what our job is now.

Senator **Wallop**. What do you anticipate doing in this interim period? You have expressed uncertainty as to the success of this new program. Whether it's successful or not, as I understand, it is that interim period that concerns you.

Mr. **Washakie**. It's a difficult problem, and—or a difficult question for me to answer. I'm probably as confused as the State is and other people—other States that have leases. But under regulations and leases that the tribes now enter into, we are dependent on USGS. The reason I say that is because the oil companies only have to report that information to USGS, do not have to report it to the tribes.

The only information that gets to the tribes is the 1424 and the 614. So we are hopeful that USGS will come up with a system that will adequately report all this information.

However, we're also looking to the future, And if the Supreme Court upholds the *Hickoria* case, which is similar to a severence tax case, the tribes have a privilege of doing business tax on oil and gas. And we would amend that and have all oil and gas producers on the reservation submit that information to us so that we can audit it and come up with that part of it.

The other part is, of course, something that this committee could do. And that is to introduce legislation that would give us some help in that area. Our primary concern right now is getting the information.

Senator **Wallop**. Do you reckon that requires legislation rather than an administrative solution?

Mr. **Washakie**. I would like to leave that decision to you. You are in a much better position than I am.

Senator **Wallop**. Not having looked at it from your perspective, I don't know. I was just asking.

Mr. **Washakie**. I would like to address that.

Mr. **Goodman**. During the course of the investigation, the USGS office in Casper, has been helpful in getting us the information we need. However, that necessarily is a time-consuming task taking document requests and weaving them through a third party. It would be much more helpful to the tribes if they are to go on their own feet and do their own accounting to have direct access to the information.

Senator **Wallop**. The ultimate goal of the tribes is to do your own accounting and be shed of the USGS?

Mr. **Washakie**. I can't answer that right now.

Mr. **Goodman**. As things currently exist, it's imperative that we do this sort of function.

Mr. Washakie. We need the information so we can try and get out.

Senator Wallop. I appreciate that, but if it is your ultimate goal, you probably ought to pass that on to the committee at some point in time.

John, do you have anything?

Senator Melcher. I want to ask Mr. Goodman if he feels that the allottees on the reservation and the tribes are necessarily adversaries in this question of working out solutions?

Mr. Goodman. I don't perceive the tribes and the allottees are necessarily adversaries.

Senator Melcher. Do you perceive any instances where they are adversaries?

Mr. Goodman. Not at the moment.

Senator Melcher. Isn't all this testimony so far based on tribal oil rather than on tribal and allottee oil?

Mr. Goodman. Yes, it is.

Senator Melcher. Well, what's the reason for that if you don't think they're adversaries?

Mr. Goodman. In large measure because the tribes are paying our bills. They are our client, and we are providing service to them.

Senator Melcher. But you are pretty sure that you can't perceive any point when the tribes and the allottees become adversaries?

Mr. Goodman. We don't perceive any at the present moment.

Senator Melcher. Have you looked down the road very far?

Mr. Goodman. Take things 1 day at a time.

Mr. Washakie. Good answer.

Senator Melcher. Which one? Do you want to answer that? Do you perceive where the allottees and the tribes may be adversaries?

Mr. Washakie. Do I—I believe that I will not answer that.

Senator Melcher. All right. I see that a member of the Shoshoni Business Council has learned how to take the fifth amendment seriously.

Mr. Goodman. Senator Melcher, you may be referring to one specific incident on the reservation in which there are problems of potential overpayments and underpayments relating to the tribes and the allottees. As representatives of the tribes in that matter we have spoken with the attorney for the allottees, have told them that we believe the complete cooperation is in both of our best interests. And I believe that is the course we will pursue.

Senator Melcher. In other words, it isn't an adversary role as far as you can see; and you have looked down the road more than 1 day at a time?

Mr. Goodman. Yes, sir, we have.

Senator Melcher. Thank you very much.

Senator Wallop. John, Pat, Leonard, thank you very much. We appreciate it. Thank you for coming down.

The next witness—we'll skip one and ask Warren Morton to come up followed by the Rocky Mountain Oil & Gas panel.

STATEMENT OF WARREN A. MORTON, MANAGER, M.K.M. OIL CO.

Mr. Morton. Thank you very much. My name is Warren Morton. I have been an independent oil producer in Casper, Wyo., since 1952. And in my role as manager for M.K.M. Oil Co., I have personally supervised both field production operations and the preparation of oil production and sales reports reuqired by both Federal and State agencies.

There are essentially four separate types of oil and gas leases in Wyoming; namely, Federal, State, fee, and Indian. Your interest is restricted to Federal and Indian leases. I have had no experience with Indian leases and will therefore address my remarks to the operation of Federal oil and gas leases.

The legitimate interests of the Government and your committee is to obtain full and accurate accounting and payment for all oil and gas produced from Federal leases. This full and accurate accounting is subject to errors by both physical losses of oil in the field and separate losses as a result of inaccurate paperwork. Each presents a separate problem.

Interest in this area has been heightened by recent reports from the Wind River Indian Reservation where some oil has apparently been stolen in the field, and there has also been a problem of misallocation of production.

I will first address the question of field operations. Oil may be lost in the field either deliberately or accidentally. Quite obviously it has always been possible for people to steal oil from a lease. The practice is as old as stealing cattle off the range. What seems to be overlooked in the recent publicity surrounding some reported thefts is that the operator is losing seven-eighths of the oil, and the royalty holder is losing only one-eighth of the oil. It is in the operator's best interest to monitor and police the field operations of his lease as carefully as possible to prevent these thefts. The thefts reported to date have usually been on isolated or some leases which are managed by a contract pumper and are receiving little direct supervision from representatives of the operator. The recent high prices of oil has obviously stimulated such illegal activities. In addition, very few people are involved in such a conspiracy.

It is my opinion that it is very unlikely that any deliberate misrepresentation of oil production and sales takes place in the larger leases in the larger fields. Too many people are involved in the daily and weekly activities to permit any clandestine operations. These larger company-operated leases have a regular pumper and a relief pumper, a regular gager and a relief gager, a supervisor and an assistant supervisor, engineers and other company personnel involved in the daily activities on the lease. The opportunity for either theft or collusion is virtually nonexistent.

There is also the possibility of an accidental loss of oil on a lease through spillage, a line break, a valve failure, or a half dozen other accidents. If the spilled oil is recoverable in pits, it is possible to make full and accurate accounting. However, it is difficult to account for oil spills that result from broken lines that seep into the surrounding land areas.

As a possible check on oil theft in the field, I could suggest two measures. The first would be to require timely reporting by an oil purchaser, either pipeline or refinery, of all truck deliveries reflecting the source point of the delivered oil. Stolen oil has to be sold somewhere, and this would provide some controls. My other suggestion is the time-proven method of offering cash rewards for any information leading to the arrest and conviction of anyone stealing oil from a Federal oil and gas lease. A well-publicized campaign should prove effective.

The other opportunity for underreporting and underpayment of Federal royalties occurs with the paperwork. Again there is the opportunity for either deliberate or inadvertent mistakes. The inadvertent mistake is the more common and can easily result from improper identity of the lease, a lost run ticket, or in today's era, a computer failure. This usually can be attributed to inept personnel or a rapid personnel turnover. Again, the operator is the largest loser since he owns seven-eighths of the oil and every step is taken by all operators to audit and monitor custody transfer transactions to catch these kinds of errors.

There is, of course, the possibility of a dishonest operator underreporting the volume of oil sales from a lease. However, he is re quired, under oath, to report production and sales on a monthly basis to the USGS, and the purchaser of the crude also files a monthly re port of purchases to all parties of interest, including the USGS. It should be a very simple matter for the Geological Survey to cross-reference the reports of the total volume of oil sales by the operator to the recorded volume of purchases of the crude oil buyer.

I might add that the volume would be very easy to identify. The problem is the appropriate price, the appropriate windfall profits tax, and the appropriate—appropriate price and what price and the windfall profit tax.

Then you have got three to four and—excuse me. I couldn't read my own notes.

In summary, I would suggest the following three steps to be taken to insure better accounting.

One. Require all purchasers of truck-delivered crude oil file a timely report with the appropriate USGS district office showing the source of the purchased oil.

Two. All monthly reports of production and sales by the producer be checked against the monthly report of purchasers by the crude oil buyer. I might add in that point, I don't see how there is any room for slip-up in there on a Federal oil and gas lease. I cannot find a buyer for oil production off a Federal oil and gas lease in which there is not a conviction order signed by the representative of USGS which calls for direct payment of the USGS share by the buyer.

Now, the USGS has my report monthly of production and run. He has the report from production from the buyers, which I cannot move the oil unless it has been approved. I fail to see where the problem arises in that area.

The third step I would recommend would be an initiation of the cash rewards and conviction of anyone stealing from the Federal oil and gas leases.

Now, Mr. Chairman, let me add a couple of comments which would come out of either today's hearing or a report that has come from your committee dealing with the alleged $1 million a day of royalty oil, royalty payments that are missing. And let me put that in some perspective for you.

Assuming a one-eighth royalty, $1 million a day of royalty oil implies $8 million a day of oil. Now, if we use the highest price for oil today, that's $34 a barrel. You are suggesting that there are 230,000 barrels a day of oil being misappropriated.

Now, put that in perspective for you. The total production in the State of Wyoming is 350,000. The total Federal production in the State of Wyoming is 220,000. Just the amount you are talking about being unaccounted for. Senator Melcher, that's three times the total production in the State of Montana. I don't think it's realistic to think that that volume of oil is suddenly disappearing and being mishandled, and no accounting for it in any place in the world.

Let me fill in a little. The official name on the top of a tank is a gage hatch, Senator. It directs—they named it thief hatch for a very specific reason. When oil is sold by the tank, the representative of the buyer and the representative of the seller samples oil top, middle, and bottom for quality, content, gravity, temperature, and BS and W and to sample this they enter a cylinder into the opening of the top of the tank with a trigger on it which is called a thief. And it thiefs a sample out of the bottom, from the middle, and from the top. These are melted together and taken appropriate samples of the oil. So they know what quality of oil is being bought and sold, and I think it's an unfair reflection on the practice of the industry to refer to the theft hatch—thief's hatch as though that were a common practice in the oil field.

Let me also express some concern that I don't understand your concern for the schematic diagram of oil flowing from wells to the tanks. As an operator where in the world would I want to flow the oil if I can't flow it to the tank where I can sell it?

And if I gave you a schematic diagram—and I bumped into this just last month, I'm taking over a possession of a lease which 20 years ago we developed, 10 years ago we sold. Then last month we took it back again. And any relationship between the piping we put in there 20 years ago and what might be there now is purely coincidental. So you have a schematic diagram. It changes every time there is a new man on the lease or new operator on the lease and so forth.

There is also an implication that no one except the royalty owner cares about, the determination of the volume and value of the oil. Well, the operator cares about that and the operator daily gages that production when he makes a custody transfer to the seller. The operator's representative personally is in constant contact with the buyer's representative, the gager. They observe either the meter readings or the BS and W sampling or the temperature correction factors. The buyer in this instance is fairly representing the royalty owners because he has seven times the interest in the value of that crude as the royalty owner does. Now, the mistakes take place. We know there is no pretending. The—the theft takes place. We know what happened. I think that you ought to keep in perspective the interests of all parties, the operator being the—virtually the same as the lessor and the possibility for dishonesty should be examined by all. And I do believe the suggestion of a check on delivered oil by trust and a reward system would be very effective in uncovering any dishonesty which might exist in the field.

Senator, thank you for letting me make not only my presentation as requested but also some observations on this day's hearing.

[The prepared statement of Mr. Morton follows:]

STATEMENT OF

Warren A. Morton, Manager

M. K. M. Oil Co.

Before the

Public Lands and Reserved Water Subcommittee of the

Senate Energy and Natural Resources Committee

Casper, Wyoming

August 11, 1981

My name is Warren A. Morton. I have been an independent oil producer in Casper, Wyoming since 1952 and, in my role as Manager for M.K.M. Oil Co., I have personally supervised both the field production operations and the preparation of all production and sales reports required by both Federal and State agencies.

There are essentially four separate types of oil and gas leases in Wyoming, namely, Federal, State, Fee and Indian. Your interest is restricted to Federal and Indian leases. I have had no experience with Indian leases and will therefore address my remarks to the operation of Federal oil and gas leases.

The legitimate interests of the Government and your committee is to obtain full and accurate accounting and payment for all oil and gas produced from Federal leases. This full and accurate accounting is subject to errors by both physical losses of oil in the field and separate losses as a result of inaccurate paperwork. Each presents a separate problem.

Interest in this area has been heightened by recent reports from the Wind River Indian Reservation where some oil had apparently been stolen in the field and there has also been a problem of misallocation of production.

I will first address the question of field operations. Oil may be lost in the field either deliberately or accidentally. Quite obviously it has always been possible for people to steal oil from a lease. The practice is as old as stealing cattle off the range. What seems to be overlooked in the recent publicity surrounding some reported thefts is that the operator is losing 7/8 of the oil and the royalty holder is losing only 1/8 of the oil. It is in the operator's best interest to monitor and police the field operations of his lease as carefully as possible to prevent these thefts. The thefts reported to date have usually been on isolated "orphan leases" which are managed by a "contract pumper" and are receiving little direct supervision from representatives of the operator. The recent high prices of oil has obviously stimulated such illegal activities. In addition, very few people are involved in such a conspiracy.

It is my opinion that it is very unlikely that any deliberate misrepresentation of oil production and sales takes place in the larger leases in the larger fields. Too many people are involved in the daily and weekly activities to permit any clandestine operations. These larger company operated leases have a regular pumper and a relief pumper, a regular gauger and a relief gauger, a supervisor and an assistant supervisor, engineers and other company personnel involved in the daily activities on the lease. The opportunity for either theft or collusion is virtually nonexistant.

There is also the possibility of an accidental loss of oil on a lease through spillage, a line break, a valve failure, or a half a dozen other accidents. If the spilled oil is recoverable in pits, it is possible to make full and accurate accounting. However, it is difficult to account for oil spills that result from broken lines that seep into the surrounding land area.

As a possible check on oil thefts in the field, I could suggest two measures. The first would be to require timely reporting by any oil purchaser, either pipeline or refinery, of all truck deliveries reflecting the source point of the delivered oil. Stolen oil has to be sold somewhere and this would provide some control. My other suggestion is the time proven method of offering cash rewards for any information leading to the arrest and conviction of anyone stealing oil from a federal oil and gas lease. A well publicized campaign should prove effective.

The other opportunity for underreporting and underpayment of federal royalties occurs with the paperwork. Again there is the opportunity for either deliberate or inadvertent mistakes. The inadvertent mistake is the more common and can easily result from improper identity of the lease, a lost run ticket, or in today's era, a computer failure. This usually can be attributed to inept personnel or a rapid personnel turnover. Again the operator is the largest loser since he owns 7/8 of the oil and every step is taken by all operators to audit and monitor custody transfer transactions to catch these kinds of errors.

There is of course, the possibility of a dishonest operator underreporting the volume of oil sales from a lease. However he is required, under oath, to report production and sales on a monthly basis to the USGS, and the purchaser of the crude also files a monthly report of purchases to all parties of interest, including the USGS. It should be a very simple matter for the Geological Survey to cross-reference the reports of the total volume of oil sales by the operator to the reported volume of purchases by the crude oil buyer.

In summary, I would suggest the following three steps be taken in an effort to insure complete accounting and payment for all Federal Royalties.

1) Require that all purchasers of truck delivered crude oil file a timely report with the appropriate USGS District Office showing the source of the purchased oil.

2) All monthly reports of production and sales by the producer be checked against the monthly report of purchases by the crude oil buyer.

3) The initiation of a well publicized program of cash rewards to persons supplying information leading to the arrest and conviction of anyone stealing oil from a Federal Oil and Gas Lease.

A word of caution. It is not possible to legislate honesty and integrity. Quite obviously the current price of crude oil is a temptation to the dishonest. No matter what security system is initiated, someone will find a way to break it. The suggestions outlined above can obviously be circumvented. However, they should provide some deterrent.

Senator WALLOP. Senator Melcher?

Senator MELCHER. I think it's always wise to hear from somebody that's been in the business a long time, to go through this from the ground up to know what the best answers or the best solutions are, Mr. Morton. So I appreciate your experience, and I appreciate your knowledge on this subject.

Now, in your testimony you mentioned that there could be a lost run ticket. How do you feel about run tickets that the GS requires on Federal leases?

Mr. MORTON. Senator, the run ticket is also the only receipt that the operator has for the delivery of his oil to the purchaser. So the run ticket is the receipt for all his production and is the only thing he has to prove ownership and get paid or his—his method of verifying payment. Run tickets are usually made out in at least triplicate if not quadruplicate. One goes to the buyer, and two copies stay with the seller.

We used to keep one in the field and one in the office, but the run tickets are terribly important to anyone who's interested in the volume and value of oil being transferred.

Senator MELCHER. So you want M.K.M. to have a run ticket, a copy of it?

Mr. MORTON. If I'm delivering by gage tank, absolutely. I wouldn't sell without them.

Senator MELCHER. Now, what do you think of those instances then when you don't have a run ticket initiated at the time the oil is picked up? Do you think that's a proper procedure? Don't you think that is really a harmful procedure?

Mr. MORTON. Absolutely, sir; but there might be an exception to that if you're looking at a LACT lease, automatic custody transfer.

Senator MELCHER. I'm not talking about a LACT meter. I'm talking about those tanks that are gaged and——

Mr. MORTON. Senator, I wouldn't let anybody take oil off of our lease without a receipt ticket. Call it run ticket; call it a delivered ticket, some sort of receipt showing that he has taken oil off of my lease because a lessee has a legal responsibility to—as to the lessor for full payment. And if I don't make full payment, I'm subject to lose my lease.

Senator MELCHER. I certainly agree. Do you know how many times the run tickets are not, prepared properly?

Mr. MORTON. You are getting now into——

Senator MELCHER. I'm not talking about your operation. Do you know how many times they are not prepared properly or what you call orphan leases?

Mr. MORTON. I can't comment on that. I obviously don't know.

Senator MELCHER. We're getting testimony coming forward all the time that isn't being followed. We went through an incident yesterday where a trucker never did have a run ticket. Maybe you don't think the trucker ought to have a run ticket.

Mr. MORTON. The real loophole for moving stolen oil is trucks.

Senator MELCHER. All right. You think he ought to have a copy of the run tickets?

Mr. MORTON. Absolutely. I see no reason why they shouldn't.

Senator MELCHER. I do too. I do too. I think your testimony is the most helpful testimony we've had so far in trying to establish this point. We want some responsibility, and I think it originates with GS on a Federal lease or an Indian lease. And we think a run ticket is a very substantial document, absolutely essential.

Mr. MORTON. I would concur.

Senator MELCHER. All right, good. Then we disagree hardly at all. I just happen to feel that things are pretty loose. We took testimony yesterday in an inquiry where the Permian trucker never has had a run ticket with him.

Now, Permian told us that they researched the law. They don't think it's required. Permian's legal staff researched the law. They don't think it's required, an that's really what prompted the response we got from GS lawyers over the past several days. They can't find now that it is really required. This is the kind of thing we're up against. You run a clean ship I'm sure, but I don't know whether all these ships are clean.

Mr. MORTON. I'm struggling with this, Senator. The implication is that an employee of a company is doing a terribly improper—let's even call it illegal thing. He's probably not doing it by implication but there has to be someone at the delivery end and someone at the receipt end to complicate this problem.

Senator MELCHER. I'm not implying that, Mr. Morton. I'm not implying that at all.

Mr. MORTON. All right. All right.

Senator MELCHER. What I'm implying is that the rules of the game—the rules that are required by law for GS to enforce are not uniform. They are not well understood, and they're not being enforced. The GS inspectors in Montana told us that they, don't know whether this run ticket must be with the trucker.

Mr. MORTON. Let me speak to the issue of the GS, and I would say that they have for the most—they are the best staffed and the best operating Federal agency which I have come in contact with. They work very hard.

Their problem is simply this: As the number of wells drilled increases, their responsibilities increase. As the amount of oil produced increases, their responsibilities increase. As more environmental regulations are applied, which they must verify and inspect, their responsibilities are increased. And it has not been matched by a followup in staff to meet the additional responsibilities.

We see this two ways in the oil field. We make an application to drill a well; we might have to wait 6 weeks before we can find a USGS inspector available to make the inspection. The same thing obviously applies in the accounting department, particularly when you consider that the accounting starts with the volume, then goes to the price schedule for oil, then goes to the price schedule for gas, then followed by a windfall profit tax in a varying schedule and so forth. Those problems are incredibly complicated. And if there was someone to blame, it is the GS employees that are there. But it is the job they've been asked to do.

Senator MELCHER. I'll accept part of the blame. Being in Congress for the past 12 years, I'm going to accept part of that blame. We sent through a——

Mr. MORTON. There is enough blame for all of us to share. I think everybody is exposed to the expanding Federal bureaucracy, and we're all opposed to that.

Senator MELCHER. If you are going to require this thing——

Mr. MORTON. All right.

Senator MELCHER. If there is something more basic in establishing the transfer then the run tickets, than being able to demonstrate that transfer of ownership, I don't know what it is. So I'm with you on feeling that that's very essential. However, we've now had this opinion that a run ticket isn't necessarily required to be carried on the truck. Well, it's certainly necessary somewhere. You spoke about cattle theft.

Well, in my State—and I assume it's the same here—if you don't have a brand inspection with you when you load a truck of cattle——

Mr. MORTON. You better not be traveling.

Senator MELCHER. You are under suspicion.

Now, I'm not implying that because these procedures are not followed it necessarily follows that there is theft. I don't know that that follows at all.

On that thief hatch, I really appreciate your explanation of that. But don't you think it's rather odd to require the sealing of all these valves out of the storage tank, but you don't seal that one up there?

Mr. MORTON. Sir——

Senator MELCHER. I know the explanation of the gas expansion, and that's easy to allow and still have a seal. But——

Mr. MORTON. No, Senator.

Senator MELCHER. You need it up there too, don't you?

Mr. MORTON. Stick a hose in from the top is what you are suggesting?

Senator MELCHER. Yes.

Mr. MORTON. There are easier ways to steal than to stick a hose into the top. And by the way, if you tie that thing down, you are going to blow your tank up for sure.

Senator MELCHER. I understand that.

Mr. MORTON. Relief valve on them, but they stick. So this thing is a heavy weight load and spring loaded.

Senator MELCHER. You would not even have to have a seal? You don't even have to have it closed. You never have it closed because the water isn't going to run in there.

Mr. MORTON. No, I—I seal it to preserve gravity there because the loss of gas otherwise would destroy the gravity of your tank and therefore depreciate the value of your product.

Senator MELCHER. You've got to allow for the expansion?

Mr. MORTON. That's true. That's true.

Senator MELCHER. Well, at any rate it's a small matter whether that's sealed or not.

Mr. MORTON. I'm appalled to hear that pipeline companies aren't sealing valves today because in all my experience in the field you just end up with a pile of flipped seals around all the valves around your tank. They even seal the valve in which you fill up on top of what they're taking out, which doesn't make any sense because they'll be the gainer on that.

Anyhow I'm appalled the number of seals that they put on tanks, and I'm shocked to learn that pipeline companies aren't doing this in the field now.

Senator MELCHER. Well, you can find out all sorts of instances if you go out and look.

Mr. MORTON. This is called human failure, and it happens.

Senator MELCHER. It does vary. It does vary considerably.

Mr. MORTON. Yes.

Senator MELCHER. Getting back to whether or not it's neccessary to have schematic diagrams, I was interested in the point you made on that. You are going to know where the oil is going because you're the operator and you run the show. But are there changes made?

Mr. MORTON. Senator, I——

Senator MELCHER. Sometimes we're finding that.

Mr. MORTON. I went to work in the oil fields in the summer of 1940 and in high school. And except for 3 years in the service, I've been working in the oil patch ever since. I've met a lot of funny characters. Some good; some not so good.

And I'm sure I've bumped into an awful lot of people who could cheerfully steal from the employer, but I've yet to meet one that's going to steal for his employer. And it's just not going to work out.

Senator MELCHER. Now, the one part you zero in on is the truck movement. And I assume that what you are recommending is something for which we've been searching for a number of months; tying down the movement in such a way that you have a check on when it reaches the refinery. If you cross check that, you know how much crude was actually removed.

Mr. MORTON. I wouldn't want to tell you that, not to shut all the doors.

Senator MELCHER. I'm driving at this point because we've had quite a bit of argument or quite a bit of discussion and testimony about trucks going to reclaimers with loads.

Mr. MORTON. This is a big door, and monitoring of their receipts and their source would be very, very helpful.

Senator MELCHER. I thank you.

Mr. MORTON. I've enjoyed the conversation.

Senator WALLOP. Warren, thank you. I just want to ask both USGS and the GAO to respond to a couple of the points you made. There seems to be some interim mechanical devices that you might be able to put into place that would be helpful. And I would like GAO and the USGS to say how it is that we have contrived to lose the equivalent production of Wyoming per day. That is an interesting figure, and if it's the case, the country probably is closer to an oil solution than it thought.

Mr. MORTON. Senator, my implication is that obviously I don't think that figure is realistic.

Senator WALLOP. I know that. However, they think it is.

Mr. MORTON. They ought to realize this volume of oil they are talking about.

Senator WALLOP. That's what I'm asking to have someone——

Mr. BAUGHMAN. The first figures was oil and gas as an estimate, but we're not trying to stick behind any 10 percent or 5 percent.

Senator WALLOP. Look, there is accountability in the accounting or there should be. That figure came out in your testimony. It's a pretty high figure, and it was more or less verified by Mr. Frederick. I think that it owes an answer. I mean, it's a hell of a lot of stuff you're talking about.

We don't need it today. We can have it by letter.

Mr. Morton. Could I get it today?

Mr. Frederick. I'd be happy to respond to that.

Mr. Bevinetto. Identify yourself for the court reporter.

Mr. Frederick. I'm Doyle Frederick, accounting director of the USGS.

The magnitude that you are talking about and the numbers that have been presented recently are the potential of the $1 million a day. And the way that $1 million a day figure has been calculated—"calculated" isn't the right word. Estimated is the right word—is based on an assumption that one might gain, and there has been some experiences on the order of 7 to 10 percent additional by putting into effect a new audit system with the proper audit followup. Then as based on a $4 billion royalty collection estimate for fiscal 1981, then one might conclude—and I'm emphasizing "might" again in this case—might conclude that underpayment of royalties, not loss of oil or gas, but underpayments of royalties could be somewhere on the order of that much.

And I think that was kind of the gist of the GAO.

Senator Wallop. That ought to be verifiable on production runs if nothing else.

Mr. Frederick. Let me say one more thing on that. On the audits that have been conducted already, I'll say I don't know that it's 7 to 10 percent. I can't tell you that because my gut feeling is that it probably isn't that high. But I just don't know.

The Inspector General from the Department of Interior has finished two very detailed audits in the past few months. One audit revealed underpayment on the order of 7 percent.

Now—now, let me emphasize again that was based on the technical interpretation of the law in terms of the way the companies chose to define proper value. And our auditors challenged them on that. So it's an interpretation of proper value, and we would guess if there is underpayment, it's of that character.

Now, the other—the other firm audited came in at somewhere under—under 1 percent of—and again, it was a technical kind of thing that they uncovered. So our responses that that's the kind of thing we're talking about. We aren't suggesting that oil theft is anywhere near that amount. We've never suggested that.

We're not even suggesting that it could be $1 million a day. We're just saying if someone assumes a 7 to 10 percent increase in collections as a result of—of additional systems in care, then it could come out that much.

Mr. Morton. I question whether $1 million a day—I heard him today. It was $1 million a day. And I would point out that the problem is in gas—gas is way underpriced compared to oil in average price. Use a 6 to 1 figure. I use $34 for oil. You have to use $6 for gas, and the average price per gas in the United States being sold now is probably $2 or less. So you're talking about three times the apparent Btu volume of gas being sold.

I think your comments—maybe I have the potential of making $1 million a day, but I'm not living up to my potential. And I think you ought to be careful when you put figures like that out because it implies a tremendous discrepancy either to a Federal agency, yourself, or to an industry by which there is maybe one spot check of one company found a discrepancy not in reported volume but in reported value. And I would suggest you get in touch with the Department of Energy because they are accusing all of the oil companies of overpricing their product. One of you has to be wrong.

Senator WALLOP. Thank you.

Mr. MORTON. Thank you, Senator.

Senator WALLOP. I appreciate it. Next is the panel of the Rocky Mountain Oil & Gas Association headed by Jack Swenson, the executive vice president. And he's accompanied by Wayne Smith of Amoco; Ron Beck, Amoco division administrative manager; and Mr. A. B. Slaybaugh, vice president and coordinating manager of the western area, Conoco.

Gentlemen, thank you for coming to share your wisdom with us. Please proceed, Jack.

STATEMENT OF JACK G. SWENSON, EXECUTIVE VICE PRESIDENT, ROCKY MOUNTAIN OIL & GAS ASSOCIATION, INC., ACCOMPANIED BY WAYNE SMITH, AMOCO; RON BECK, MANAGER, ADMINISTRATIVE DIVISION, AMOCO; AND A. B. SLAYBAUGH, VICE PRESIDENT AND COORDINATING MANAGER, WESTERN AREA, CONOCO

Mr. SWENSON. Thank you. There has been so many comments about audits and errors that I must say that the statement that was distributed was well audited, but pages 4 and 5 are reversed in some of the copies and maybe—thank you.

Mr. Chairman, Senator Melcher, my name is Jack Swenson. I'm executive vice president of the Rocky Mountain Oil & Gas Association RMOGA.

RMOGA is an organization of some 750 large and small companies and individuals who operate in the Rocky Mountain States, representing in all more than 50,000 men and women engaged in oil and gas industry operations.

We appreciate the opportunity to appear here today at this hearing concerned with the subject of mineral royalties on Federal and public lands and Indian lands and their collection, accounting, and distribution. In view of some of the serious concerns about mismanagement and alleged fraud in the accounting and payment of royalties for crude oil produced on private land, it's most important that we shed as much light as possible on procedures now in use and on improvements now in the works.

We want to emphasize that the allegations which have been made characterize the worst I think of the broad brush portrayal of this industry as a collection of black hats.

I emphasize that is a totally unfair picture. Let me stress at the outset that our hundreds of members who operate thousands and thousands of producing leases do not all conduct all of their operations in the same identical manner. Each company has its own procedures, and each lease may vary. Yet in every case the object of the accounting procedure is to carefully account for each barrel of oil produced, and to make the proper payments to those to whom payment is due.

Now, because of these procedural differences we would like to use a specific example of how companies typically handle crude oil produced on the Wind River Reservation and the royalty payments thereon.

I'm going to summarize by moving down in the text to emphasize that our members report all production from the reservation on the U.S. Geological Survey Form 9-329, monthly report of operations. This form reports by well and by lease the volume of oil produced, the volume of water produced, and the number of days during the month that each well was producing.

In addition this form reports the amount of oil on hand at the start of the month of each tank battery, the amount of produced oil that was received by that battery during the month, the amount sold from that battery, and the amount on hand at the battery at the end of the month.

The original and at least one copy of form 9-329 are sent directly to the U.S. Geological Survey office in Casper.

One record company is retained—a copy rather is retained at the operating company's local office. All members' crude oil production volumes from the Wind River Reservation should be properly reported through the mechanism of that form 9-329.

The monthly royalty payment prepared for the accounts of the Shoshoni and Arapahoe Tribes are initially forwarded to USGS offices in Casper with original and copies of the rental and royalty remittance advice form. That's form 9-614A. Each operating company also prepares a monthly report of sales and royalty, form 9-361, which reports the gross volume and the value of oil sold from each of the leases.

The USGS reporting requirements stipulates that reports be separated between current month activity and adjustments of payments and reports made in prior months. Therefore, any adjustments for prior months requires, for example, as a result of retroactively effective regulation or price changes must be accounted for by a separate amended report with the USGS showing only the prior period adjustment.

Now, in an effort to effect those adjustments as soon as possible, the monthly Indian royalty checks are adjusted manually. Unfortunately, due to the complexities brought about by the numerous DOE price categories of oil and frequently changing interpretations, some errors were made in the manual preparation of the checks. The royalty payment preparation process which I have described and the complexity of handling systems 10 or 11 tiers of crude oil with frequently changing allowable prices for the major factors increasing the possibility of occurrence.

We are greatly encouraged by the solution which we see developing in two ways: First, the problem of keeping track of so many production categories of crude oil in order to adjust royalty payments has been removed by crude oil decontrol.

Second, the USGS has been developing a new computerized royalty management system. This new system promises significant improvements which may help expedite accurate and timely payments of Federal and Indian royalties.

While companies have been providing extensive lease information to USGS to assist in establishing the new royalty management system. Royalty data processing will be centralized in USGS's regional auditing office.

We earnestly hope that the royalty management system reporting format will be compatible with computerized company data. If it is not, the problem may be compounded instead of relieved. If it is compatible, this new system, combined with the simple sophistication of oil pricing regulations, should allow our member companies to eliminate the manual processes—of royalty payments and reports, thus reducing the factor of human error.

Now, assuming a properly developed format in which industry input is recognized, we would enorse congressional support for the new royalty management system and for carefully reviewing the budget of the USGS not only to provide the ability to inspect oil operations on public and tribal lands but more importantly to provide for adequate auditing procedures.

The new system promises greater production for the interest of producers and Federal and Indian royalty owners.

The improvements being developed by USGS will reduce paperwork. They should expedite payments of Federal and Indian royalties. They should increase the level—we believe they will increase the level of confidence that the Indian leadership and the Federal Government should have in oil producers and in the proper management of oil royalty payments.

Now, Mr. Chairman, Senator Melcher, should there be questions, I am accompanied today, as you indicated, by Mr. A. B. Slaybaugh of Denver who is vice president and coordinating manager for the western area of Conoco Inc.; Mr. Wayne Smith, who is division operating superintendent for the northern division of Amoco Production Co.; and Ron Beck, also of Amoco, their division administrative manager for their northern division, both of them from Denver.

If there are questions that we cannot answer this afternoon, we'll certainly attempt to obtain the answers for you.

[The prepared statement of Mr. Swenson follows:]

STATEMENT OF
Jack G. Swenson, Executive Vice President
Rocky Mountain Oil and Gas Association, Inc.
Before the
Pubilc Lands and Reserved Water Subcommittee of the
Senate Energy and Natural Resources Committee
Casper, Wyoming
August 11, 1981

Thank you, Mr. Chairman. My name is Jack Swenson, and I am Executive vice-president of the Rocky Mountain Oil and Gas Association (RMOGA).

RMOGA is an organization of some 750 large and small companies and individuals who operate in the Rocky Mountain states, representing in all more than 50,000 men and women engaged in oil and gas industry operations.

RMOGA appreciates the opportunity to appear today at this hearing concerned with the subject of mineral royalties on federal and public lands, and their collection, accounting and distribution. In view of some serious concerns about mismanagement and alledged fraud in the accounting and payment of royalties for crude oil produced on tribal lands, it is most important that we shed as much light as possible on procedures now in use and on improvements now in the works. We want to emphasize that the allegations which have been made characterize the worst of a "broad brush" portrayal of this industry as a collection of "black hats." It is a totally unfair picture.

Mr. Chairman, let me stress at the outset that our hundreds of members, who operate thousands and thousands of producing leases, do not all conduct all of their operations in the same identical manner. Each company has its own procedures and each lease may vary, yet in every case, the object of the accounting procedure is to carefully account for each barrel of oil produced, and to make the proper payments to those to whom payment is due.

Because of these procedural differences, we would like to use a specific example of how companies typically handle crude oil produced on the Wind River Reservation, and the Royalty payments thereon.

From a well, untreated crude oil is piped to a header where it is directed to a so-called "free-water knockout" unit where, by gravity, part of the water is removed. Next the oil is piped to a heater-treater unit, where remaining water and basic sediments are removed by a heating process. The oil is then piped to storage tanks in a tank "battery" until sufficient quantities are gathered for delivery into the pipeline for sale.

From the storage tanks, the oil is piped to a Lease Automatic Custody Transfer (LACT) unit. At the LACT unit, the oil is measured for temperature and quality by automatic probes. If the oil fails to meet pipeline quality specifications, it is rerouted back to a tank in the tank battery for recycling through the heater-treater unit. If the oil meets pipeline specifications, it passes through the LACT unit meter and flows into a pipeline for sale.

At the LACT unit, each volume of oil that is delivered into the pipeline for sale is measured and the volume is recorded on- the LACT unit ticket. The LACT unit automatically starts up and shuts down as the storage tank in the tank battery fills and empties. Each day's run of oil through the LACT unit and into the pipeline for sale is printed on the ticket in sequence, and approximately every 15 days the LACT unit is unlocked and representatives of both the buyer and seller are present to witness and verify the entries.

In addition to the automatic printouts which the LACT unit produces, each LACT unit meter has a non-resettable barrel counter which measures the total flow of crude oil into the pipeline. The lease operator manually records this reading each day so that dayto-day volumes are available in a timely manner.

In the vast majority of cases, all of our members' production on the Wind River Reservation that is delivered into a pipeline for sale is measured by these automatic LACT units.

Small quantities of oil may be trucked (in this case, truck operators and the seller or the pumper who represent the seller) records the quality and quantity of the trucked oil on a run ticket. That information may be hand-gauged in some instances. This run ticket, which is sequentially numbered for additional control purposes, then is processed through the same control system as pipelined oil.

Our members report all production from the Reservation on the U.S. Geological Survey Form 9-329, Monthly Report of Operations. This form reports, by well and by lease, the volume of oil produced, the volume of water produced, and the number of days during the month that each well was producing.

4

In addition, this form reports the amount of oil on hand at the start of the month at each tank battery; the amount of produced oil that was received by that battery during the month; the amount sold from that battery; and the amount on hand at the battery at the end of the month.

The original and at least one copy of Form 9-329 are sent directly to the U.S. Geological Survey office at Casper. One record copy is retained at the operating company's local office.

All members' crude oil production volumes from the Wind River Reservation should be properly reported through the mechanism of Form 9-329.

Monthly royalty payments prepared for the accounts of the Shoshone and Arapahoe Tribes are initially forwarded to the USGS office in Casper with original and two copies of the Rental and Royalty Remittance Advice Form 9-614-A. Each operating company also prepares a Monthly Report of Sales and Royalty Form 9-361, which reports gross volume and value of oil sold from each of the leases. The USGS reporting requirements stipulate that reports be separated between current month activity and adjustments of payments and reports made in prior months. Therefore, any adjustments for prior months required, for example, as a result of retroactively effective regulations or price changes must be accounted for by filing a separate, amended report with the USGS showing only prior period adjustments. In an effort to effect those adjustments as soon as possible, the monthly Indian royalty checks are adjusted manually. Unfortunately, due to the complexities brought about by the numerous DOE price categories of oil and frequently changing interpretations, some errors were made in the manual preparation of the checks.

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The royalty payment preparation process which I have just described, and the complexity of handling as many as ten or eleven tiers of crude oil with frequently changing allowable prices, were major factors increasing the possibility and occurrence of accounting errors.

In view of these difficulties, we are greatly encouraged by solutions which we see developing in two ways. First, the problem of keeping track of so many different production categories of crude oil in order to adjust royalty payments has been removed by crude oil decontrol. Second, the USGS has been developing a new, computerized Royalty Management System. This new system promises significant improvements which may help expedite accurate and timely payments of Federal and Indian royalties.

Our companies have been providing extensive lease information to USGS to assist in establishing the new Royalty Management System. Royalty Data Processing will be centralized in USGS regional auditing offices. We earnestly hope that the royalty management system's reporting format will be compatible with our computerized company data. If it is not, the problem may be compounded instead of relieved. If it is compatible, this new system, combined with the simplification of oil pricing regulations, should allow our member companies to eliminate the manual processing of royalty payments and reports, thus reducing the factor of human error.

Assuming a properly developed format in which industy input is recognized, we would endorse Congressional support for the new Royalty Management System and for carefully reviewing the budget of USGS not only to provide the ability to inspect oil operations on public and tribal lands, but more importantly to provide for adequate auditing procedures. The new system promises greater protection for the interests of producers, and Federal and Indian royalty owners.

The improvements being developed by USGS will reduce paper work and expedite payments of Federal and Indian royalties. They will increase the level of confidence that the Indian leadership and the Federal Government should have in oil producers and in the proper management of royalty payments.

Mr. Chairman, should there be questions, I am accompanied today by Mr. A. B. Slaybaugh, of Denver, vice president and coordinating manager for the Western Area of Conoco, Inc.; Mr. Wayne Smith, Division Operating Superintendent for the Northern Division of Amoco Production Company, also of Denver and Mr. Ron Beck, Division Administrative Manager of Amoco Production Company's Northern Division and he is also from Denver. If there are questions we cannot answer this afternoon we will certainly attempt to obtain the answers for you.

Again we appreciate the opportunity to appear here today.

Senator WALLOP. Thank you, Jack. I appreciate it. Senator Melcher?

Senator MELCHER. You made the telling point here, Jack, on page 6—which is in the proper sequence, I might say, in my copy of the statement you said, "Assuming a properly developed format in which industry input is recognized, we would endorse congressional support for the new royalty management system."

Now, they've got 42 employees. They've told us that much and a few bucks invested—I mean quite a few bucks invested in what's going on in Denver. Have you had input into what's been going on so far?

Mr. SWENSON. I directly wouldn't have, Senator; but some of our members have.

Senator MELCHER. Do you think your members have? Which ones?

Mr. SWENSON. The——

Senator MELCHER. Are any of them here to speak for themselves?

Mr. SWENSON. I don't know. Ron, can you?

Mr. BECK. Our controllers department in Tulsa—our Tulsa data center has for Amoco, and I can't speak for Conoco.

Senator MELCHER. How about Conoco?

Mr. SLAYBAUGH. I don't know for sure, Senator.

Senator MELCHER. Well, you know, we're going to have something going in September. So if you are going to have a format for input in its development, what do you think that format should be? Is that through the blue ribbon committee or through the GS directly; or Denver, or what?

Mr. SWENSON. We would hope that there would be an inquiry directed to us.

Senator MELCHER. From GS?

Mr. SWENSON. That we could respond to from GS and from the blue ribbon group.

Senator MELCHER. I think it's obvious that this subcommittee, the energy committee, is most interested in getting your recommendation.

Now, you are talking mostly about LACT meters. Well, you want to talk about run tickets at all? Do you have an opinion?

Mr. SLAYBAUGH. I might just make a comment on run tickets. Ours are numbered sequentially, and those who are in charge of them better be able to answer for every one of them. And they are reconciled every month. You start out with one number at the first of the month. Those tickets better all be in. You better have the right ticket at the end of the month.

And our crude oil, where it is trucked, if trucked by company trucks and company employees, and they must have a run ticket.

Senator MELCHER. They must have a run ticket?

Mr. SLAYBAUGH. You bet.

Senator MELCHER. On the truck?

Mr. SLAYBAUGH. Yes.

Senator MELCHER. You think that's elementary?

Mr. SLAYBAUGH. I see no other way to do it.

Senator MELCHER. Well, I'm glad you are testifying today in the presence of Mr. Frederick because I think it's elementary too. I think it's absolutely preposterous that we've been told by USGS personnel in one area that a run ticket has to be with the trucks, and then in another area just north of here in the same region, well, we never do it. We never have.

Mr. **Slaybaugh.** I don't know how you would check on the quality of the oil, Senator.

Senator **Melcher.** The question was whether it should be with the truck.

Mr. **Slaybaugh.** Yes; because it's got to deliver it to some point.

Senator **Melcher.** That's right, I agree with you. I think it's elementary. I think it's basic. Perhaps most of the oil that you are involved with goes through LACT meters. There must be substantial quantities other than in Montana that is trucked yet to——

Mr. **Slaybaugh.** Oh, yeah. In fact in almost any new area, Senator, before you get a pipeline you end up trucking it. That's the first step that you take. You got to get the oil out of the area before you get the pipeline in. So whether it's a small area or large discovery, you start out by trucking.

Senator **Melcher.** Thank you very much.

Senator **Wallop.** I only have one thing that maybe you can answer now. That is: When you talk about a compatible computerized system with company equipment and data, and earlier described the variety and diversity within your industry, is that going to be possible to get an industry-wide computer relationship to marry with the USGS?

Mr. **Swenson.** Let me make a brief comment there. Referring back to a period several years ago when DOE was established and programs were set up, and then each of the States set up their own program. And there was a tremedous variance, but in—eventually in no case was there anything that was compatible with what already existed in the industry. I think that's basically correct. I think that——

Senator **Wallop.** Do you know how that's progressing? Is anybody talking compatibility with the industry?

Mr. **Frederick.** Yes, sir. Yes, sir, we—we had industry representation on—on our original panel that helped to lay out conceptually the—the improved royalty management system. And one of the improvements that—that we felt was a must was to be compatible—computer compatible with industry. So we agree wholeheartedly with what they're saying in terms of the ability and have been consulting with them. And obviously as we work the system we'll consult more thoroughly.

I don't know that we're going to be able to be compatible with each and every firm, but it is of concern. And we did have industry input earlier on, and as a matter of fact we had full cooperation from industry in terms of this is a good idea. You ought to be going in this direction for the most part.

Mr. **Petty.** I participated in those discussions, and I keep falling back on social security and withholding taxes where your large companies—where your large companies report by tape. And both IRS and social security are able to—through their software to convert that. So there is going to be a way to make it compatible.

Senator **Wallop.** That's what I was hoping would happen, but that's not what did happen with DOE.

Mr. **Petty.** There is a lot of things that didn't happen with DOE.

Mr. **Frederick.** Senator Wallop, that's one of our high priority objectives, of course, is to be as compatible as we possibly can because if we receive information on computer compatibility, it's much easier for us to process and respond quickly.

Chairman WALLOP. So generally speaking, if we could go on, you figure it might lighten your paperwork load if it was done well. You have indications now that it's progressing in that direction?

Mr. SWENSON. I couldn't respond to that at this point beyond what Mr. Beck has said.

Senator WALLOP. If you report back on that, I think it would be useful. It would seem to me at this stage—they haven't even let the design contract yet—that you'd be talking directly with the various associations like RMOGA as well as some of the larger producers that are among the 25 who pay the 80 percent.

Mr. FREDERICK. Senator, we are indeed talking, and I think we've talked to RMOGA, surely a representative of the organization, and in addition to providing Senator Wallop that kind of information, if you feel that we're not going far enough to take into account your existing information or systems, please let me know too. I don't know how much at least we—we ought to take that into account.

Senator WALLOP. Much obliged. I want to say one other thing. That has not, at least in my interpretation of most of the events, been an accusation of the industry as black hatted and especially at this hearing. So I hope you go at least with that in mind that the committee arrived with an open attitude.

Mr. SWENSON. Thank you, Senator.

Senator MELCHER. Mr. Chairman, before we depart, would Mr. Slaybaugh——

Mr. SLAYBAUGH. Yes.

Senator MELCHER. And you are with Conoco?

Mr. SLAYBAUGH. Conoco.

Senator MELCHER. And do you people with Amoco agree on this run ticket? Are you as firm as Mr. Slaybaugh?

Mr. SMITH. Yes; we've always believed in run tickets.

Senator MELCHER. With a truck or not?

Mr. SMITH. Yeah, with the truck. Of course, you have several copies. The truck driver should have one, and they should leave one at the lease where it was picked up.

Senator MELCHER. And that's standard operating procedure with both of your companies?

Mr. SLAYBAUGH. Yeah.

Senator MELCHER. And you testified that you owned the trucks. So you have control of everything? That's the same?

Mr. SMITH. Everything on the Indian reservation, you know, is run through LACT units. But we get involved in new leases.

Senator MELCHER. On the Wind River it's all LACT units?

Mr. SMITH. We're not truck——

Senator MELCHER [continuing]. When you do truck for Amoco?

Mr. SMITH. You truck from all their leases.

Senator MELCHER. Are you talking about both Federal leases and private leases?

Mr. SLAYBAUGH. Doesn't matter. It's just like a check.

Senator MELCHER. I agree. It's so refreshing to have somebody get down to the basics on this and not to be whipsawed back and forth from what GS said last winter and what GS said this summer. And I don't think anybody wears black hats, not even GS by the way.

Mr. SLAYBAUGH. Senator, if you've ever lost a run ticket, you don't lose one more than one time.

Senator WALLOP. Takes you quite a while to get it back?

Mr. SLAYBAUGH. The next time you are not around.

Senator MELCHER. Well, you should have been with us yesterday when we went through an inquiry where they testified they never had a run ticket with a truck, never had. And where the guy who was running the operation for Williams said that his boss never did chew him out over this incident. I guess he knew why, because there wasn't any gage where the owner was present, wasn't anything, you know. And it is run differently in different places. I think it's pretty essential to show some of the basics with the oil as it's transported. I thank you again.

Senator WALLOP. Thank you very much. We appreciate it. Is Jim Barlow here? I haven't seen him. OK, Bob Sick? Is he here? Well, we have run out of names on our list.

I want to express my appreciation to you, John, for having come down and shared this afternoon with me.

Senator MELCHER. Thank you veiy much, Malcolm. I want to compliment you on holding this hearing. I think it's been most helpful, and I think it's most productive and constructive as we go on in making these procedures for a royalty accounting system.

Senator WALLOP. Well, I'm glad you were here. And I appreciate those who participated in and the effort that is required to get here. And I would like to thank the staff for all the help that they gave in putting on this hearing today.

I hope you go home as controlled as you arrived. With that the hearing is adjourned.

[Whereupon, at 5:08 p.m., the hearing was adjourned.]

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